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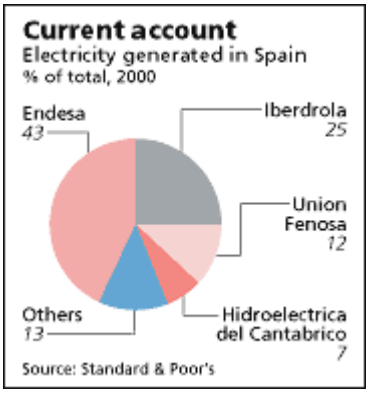
Business this week

Feb 8th 2001
From The Economist print edition

Pulling the plug

Endesa, Spain's largest electricity utility, and **Iberdrola**, the second-largest, called off what would have been the country's biggest ever merger. Iberdrola will now be eyed by other European and American electricity firms. Two further suitors joined the bidding for **Hidroelectrica del Cantabrico**, Spain's fourth-largest electricity utility. **RWE**, Germany's largest power company, offered *euro*2.9 billion ($2.7 billion); **EnBW**, Germany's third-largest, in association with Ferroatlantica, a Spanish concern, offered slightly less.



See article: Spain's failed power merger

Enron, a giant American utility, asked the Indian state of Maharashtra to pay 790m rupees ($17m) owed to it by the state's electricity board, for power supplied from its government-underwritten Dabhol plant. Maharashtra said that it would love to help but could not afford to. The state appealed to the federal government, which said it would stump up some cash.

Defying orthodoxy, **Phillips Petroleum**, an American oil company, bought Tosco, a refining and retailing business, with shares worth around $7.5 billion. Most big oil companies have shed downstream businesses in favour of more lucrative oil exploration and production.

Suez Lyonnaise des Eaux, a French utility, was reported to be considering a radical cutback. The company is ready to ditch 80% of its name—considered too long and too French—and become just "Suez".

The European Commission said it had started antitrust investigations into a proposed $45 billion acquisition of **Honeywell International** by **General Electric**. Worries centre on the ability of a combined concern to use its market power in the supply of aircraft parts.

Ryanair, an Irish budget airline, said that profits for the quarter to the end of December were up 42% and forecast that by 2003 it would have 14m passengers. Online ticket sales (65% of the total) have helped cut costs and make Ryanair one of the world's most profitable airlines.

Orange squeezed

France Telecom responded to mounting doubts over the prospects for mobile-phone operators by slashing the flotation price of Orange, its mobile subsidiary. Orange, previously priced at up to *euro*64.8 billion ($60.4 billion) will now be priced at between *euro*45.6 billion and *euro*52.8 billion. Earlier valuations had reached *euro*150 billion.

Bertelsmann, a privately held German media group, took steps towards going public. It acquired 30% of **RTL**, a European broadcaster, from **Groupe Bruxelles Lambert**, a Belgian holding company, in exchange for 25.1% of its own shares. GBL has the right to take the shares to market within four years, finally allowing outside investors a stake in Bertelsmann.

See article: Bertelsmann eyes the stockmarket

News Corporation was said to be close to acquiring **DirecTV**, an American satellite-TV company owned by General Motors through its Hughes subsidiary, for around $70 billion. News Corp will add DirecTV to its satellite business, Sky Global Networks, and gain a long-sought North American operation for its worldwide broadcasting empire.

Investors were startled when **DaimlerChrysler** made an early announcement of earnings in 2000, revealing a drop in net income of 44%. Most of the problems are at Chrysler, the firm's American operation.

Shrinking Japan

Japan's GDP for the third quarter of 2000 was revised down to show a 2.4% decline at an annual rate, providing fresh evidence that the country is suffering a continuing slowdown. The Bank of Japan has come under increasing pressure in recent weeks to loosen monetary policy and provide some encouragement for Japan's ailing economy.

See article: Propping up Japan's stockmarkets

America's labour productivity growth slowed to an annualised 2.4% in the fourth quarter of 2000 compared with 3% in the previous quarter; unit labour costs rose at an annual rate of 4.1%. However, productivity growth, for the whole of 2000 was 4.5%, the biggest increase since 1983. America's unemployment rate also rose, to 4.2% in January from 4% in December.

See article: Productivity in America

Equitable solution?

Halifax, a British bank, appeared to have sealed a deal worth up to £1 billion ($1.5 billion) to buy Equitable Life, the world's oldest mutual life-assurance company. **GE Capital** had a first (higher) offer rebuffed and, refusing to admit defeat, came back with another. Too late, said Equitable. The company has been up for sale since a ruling that it had acted illegally by cutting guaranteed pay-outs had left it with liabilities of £1.5 billion.

As widely expected, the **Bank of England** cut its key interest rate by a quarter point to 5.75%. The move follows low inflation figures and growing concerns about the impact of a downturn in America.

See article: The Bank and interest rates

America's leading banks are involved in **laundering billions of dollars** according to a report issued by Democratic staff on the Senate investigations subcommittee. Correspondent accounts, allowing foreign banks to maintain accounts with American counterparts, have allowed "rogue foreign banks and their criminal clients" to legitimise their ill-gotten gains. It is unclear whether America's new administration will be as tough on money laundering as the previous one.

Appreciating assets

Christie's put an array of James Bond memorabilia on display ahead of an auction on February 14th. Interest centred on the **bikini** worn by Ursula Andress as she emerged from the sea in "Dr No". It is expected to raise £40,000 or more.

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The world this week

Feb 8th 2001
From The Economist print edition

Israel's right turn

Reuters

Ariel Sharon won a landslide victory in Israel's prime-ministerial election, defeating Ehud Barak, who resigned as Labour's leader. Israelis' preoccupation with security was heightened when a car-bomb exploded in Jerusalem.

See article: Sharon's Israel

After two months of stalled talks, **Ethiopia and Eritrea**, which signed a peace deal in December, agreed to create a UN-controlled buffer zone along their disputed border.

Rwanda's president, **Paul Kagame,** gave the UN Security Council his terms for withdrawing his army from Congo. Mr Kagame, who supports the Congolese rebels, also met Congo's new president, Joseph Kabila.

See article: Rwanda's genocide suspects go online

The UN's refugee agency is struggling to reach 170,000 **refugees** trapped in southern Guinea by renewed fighting between the Guinean army and Sierra Leonean rebels.

Lawyers for Abdelbaset Mohmed al-Megrahi, a Libyan agent jailed for life in the **Lockerbie** bombing case, lodged an appeal against his conviction by a Scottish court sitting in the Netherlands.

No justice

Indonesia's embattled president, **Abdurrahman Wahid**, fired his justice minister, Yusil Ihza Mahendra, for publicly siding with critics of the president's financial affairs. He was the second cabinet minister to leave in the past month. In Surabaya, Indonesia's second-biggest city, thousands of Mr Wahid's supporters went on a rampage, calling for the death of politicians who want him impeached.

See article: Wahid talks tough in Indonesia

In the politically unsettled Philippines, **Joseph Estrada** asked the Supreme Court to confirm that he was still the lawful president and immune from prosecution for corruption. Gloria Macapagal Arroyo took over the presidency after the army withdrew support from Mr Estrada.

See article: Estrada refuses to go quietly

EPA

Officials in Japan's southern island of **Okinawa** demanded the sacking of the local American military chief, Lieutenant-General Earl Hailston, for calling them "nuts and wimps". The bulk of America's 48,000 military personnel in Japan are stationed on Okinawa.

The Red Cross and Red Crescent said that 50,000 people may have died in the **Indian earthquake** of January 26th, twice an earlier estimate, and that more than 1m were in need of food, shelter and clean drinking water.

Elf visitor

Alfred Sirven, a former senior man at Elf, a **French** oil company, was extradited from the Philippines, where he had taken refuge several years ago, and flown back to France via Germany to face corruption charges. Prosecutors view him as a key witness who might help them nail other defendants in the case, including Roland Dumas, a Socialist former foreign minister.

See article: The key to a French scandal?

Bernard Kouchner, a French doctor who ran Kosovo for the United Nations from 1999 until last month, was again made France's health minister.

AP

One of the biggest demonstrations since the Soviet Union's fall took place in **Ukraine**'s capital, Kiev, against the alleged corruption and mismanagement of President Leonid Kuchma's administration.

Russia's deputy chief of staff of the army contradicted a recent assertion by President Vladimir Putin that Russian troops would start being withdrawn from Chechnya.

See article: Russia's stalemate in Chechnya

Units of the Yugoslav army had their heaviest exchange of fire for two months with ethnic-Albanian guerrillas operating in a strip of **Serbia** close to Kosovo's eastern border.

The **European Union**'s commissioner for the internal market, Frits Bolkestein, a Dutchman, stirred controversy in Brussels when he issued a paper that argued against harmonising business taxes across the Union.

See article: Is EU tax harmonisation dead?

Tax incentive?

President George Bush unveiled his $1.6 trillion tax-cut plan, selling it as a matter of fairness and an incentive to the poorly paid to work. Critics pointed out that most of the cuts would still go to wealthier Americans. Mr Bush said he intended to make parts of the plan apply retroactively, from the beginning of this year.

See article: Unveiling the tax cut

Bill and Hillary Clinton continued to draw loud criticism for their decision to take $190,000-worth of gifts from the White House, besides $28,000-worth of furnishings. Mr Clinton offered to pay for some of it.

See article: The Clinton scandals continue

In **Haiti**, Jean-Bertrand Aristide was sworn in again as president. He held the job in 1990-95, spending three of those years in exile because of a military coup. Foreign aid donors want a parliamentary election last year to be rerun, but talks about it between Mr Aristide and the opposition broke down.

See article: Aristide again in struggling Haiti

In **Venezuela** a cabinet shuffle was accompanied by signs of tensions in the armed forces. President Hugo Chavez, moved Jose Vicente Rangel, his leftist foreign minister, to the defence ministry, but then gave most of his powers to the chief of the armed forces, a newly created post.

See article: Venezuela's cabinet shuffle

Ecuador's government declared a state of emergency, after thousands of Indian farmers staged protests against IMF-backed austerity measures. Four protesters were killed. The government later agreed to reduce a recent rise in the price of cooking gas.

See article: Ecuador's battle over cooking gas

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Sharon's Israel

Feb 8th 2001
From The Economist print edition

Get article background

SO DOES the sky fall in, now that the Israelis have overwhelmingly chosen Ariel Sharon to be their prime minister? No, but it is darkly overcast. In his younger years, Mr Sharon committed, or allowed others to commit, deeds that were vile, dangerous and sometimes both. But the past is another country. Mr Sharon's current concern is to demonstrate his new-found maturity, and his ambition is to create a broad coalition (see article).

If he succeeds, nothing much may change—with the big exception that the seven years spent weaving a permanent settlement between Israel and the Palestinians will have come to an end. The Oslo process, which began with the signing of a declaration of intent on the White House lawn in September 1993, has run its course. The search for a permanent peace, probably under a different formula, will be resumed at some point. But for the moment it is over.

One of Mr Sharon's most popular campaign promises was that he would not allow any talk of peace so long as violence persisted. Fine, but his related pledge, to end the violence, is unconvincing. Israelis elected him because they believed that he would somehow make them safer from Palestinian attack. Although Israel has long since stopped feeling threatened as a nation-state, nearly 50 Israelis have been killed since the Palestinian *intifada* (uprising) broke out at the end of September. The voters dismissed Ehud Barak, who acknowledged their decision by resigning as Labour's leader, because they blamed him for their personal insecurity.

But what can a Sharon government do that a Barak government did not do? The Israelis, resenting the criticism, have already been chided for excessive use of force—shooting to kill by snipers, bombing from helicopter gunships—and for the collective economic punishment of every single Palestinian. As Palestinian casualties soared, local Palestinian leaders changed their tactics in order to raise the cost to Israel: soldiers and settlers were declared legitimate targets. Mr Sharon may hope to silence the revolt by even fiercer retaliation—he has talked of wholesale house-demolishing—but, at this stage in the *intifada*, ferocity is more likely to deepen the cycle of violence and counter-violence than to halt it.

Should the rest of the world be bothered?

A bad, sad outlook, but need the world care more about this bit of the Middle East than it does about the hideous things that happen in other corners of the globe? Israel and the Palestinians attract disproportionate attention. Israel, a tiny democratic state of 5m Jews and 1m Arabs, gets the coverage of a front-ranking nation; the Palestinians, with 6m-7m people, nearly half of them in the West Bank or Gaza, are a hard-done-by minority but no more than, say, the Kurds. Yet ex-President Bill Clinton engrossed himself for weeks on end in the details of peacemaking, and the world's media has been riveted by an election at which relatively few Israelis even bothered to vote.

The reason, or so it used to be believed, was that Israel, seen by Arabs as an inflammatory cuckoo in their nest, could be a pretext for world war, either the fighting sort or the economic. This made sense when the Soviet Union and America glared at each other behind their respective Middle Eastern champions, or when the Arab oil states, during Arab-Israeli war in the 1970s, trebled the price of their product. But the Soviet Union is long gone, as is the fear that Arabs "in the street" can force governments to action. Mainstream Arab states, which once saw Israel as a danger that could be got rid of, now see it as a nuisance to be lived with: they will support the Palestinians and, more seriously, the Islamic cause of Jerusalem's holy places, but only in ways that are in their own interests.

Hosni Mubarak put the present in perspective when he replied, on Israeli television, to the wild remark by one of Mr Sharon's wilder sidekicks, Avigdor Lieberman, that Sharon's Israel might contemplate bombing the Aswan dam. "Who is talking about war?" asked Egypt's president, "we are looking for stability, not war." Israel's cold peace with most of the Arab world, colder than ever since the start of the *intifada*, will continue, safely if uncomfortably for Israel.

A few danger-points remain: Iraq, which fired missiles at Israel during the Gulf war, could presumably do so again. Iran, a non-Arab country, is resolutely anti-Israel, and the Syrian-Lebanese imbroglio remains unsolved. Israel has pulled out of Lebanon, but a sliver of land is disputed and Hizbullah, which recently kidnapped four Israelis, keeps the area tense. Mr Sharon's own track-record adds to the tension: in 1982 he plunged Israel into its long misadventure in Lebanon, allowing his Christian-Lebanese allies to commit atrocities in the Palestinian refugee camps. He used to be a dangerous grand-strategist: his Lebanese invasion was supposed to lead, by a series of stages, to a Palestinian takeover in Jordan, and thus the end of Israel's own Palestinian problem.

So there are still fears. Iraq and Iran are no more reconciled to Israel than they were, and Mr Sharon still sees Jordan as the ultimate answer for the Palestinians. He has also made it plain that he would not withdraw from the Golan Heights in exchange for peace with Syria. Accidents can happen. But the prospect of a regional war—which was used by some of Mr Sharon's domestic opponents as a threat—remains remote.

So it is not the fear of a wider war that binds the West to the Israeli-Palestinian mess. The involvement is historical, maybe unbreakable. From the Palestine mandate to the Holocaust and beyond, Europe's responsibility is carved in stone. America linked itself to the region rather later, through conscience, realpolitik and its Jewish lobby. It is an in-the-face fact that infinitely more people die violently from earthquake, flood and disease. But the knotty little problem of how a roughly equal number of Israelis and Palestinians can share a tiny patch of shoreline, hills and desert remains as absorbing as ever. Mr Sharon's entry has complicated matters, almost certainly putting a solution back a few years. But outsiders, however wearily, just have to go on trying to find one.

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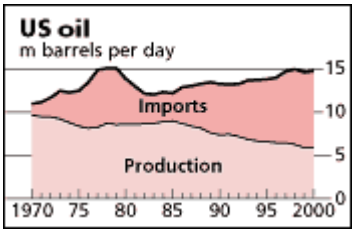
Alaska or bust

Feb 8th 2001
From The Economist print edition

The Bush administration is worried about an "energy crisis". That is the wrong way to frame policy



AMERICA is about to enter the Dark Ages. So you would conclude, anyway, listening to George Bush talk about energy. The electricity mess in California, which has left its biggest utilities nearly bankrupt and their customers enduring power cuts, is indeed a crisis—but that is not, or not just, what the president is talking about. He says he is "deeply concerned" about a broader energy shortage: "It's becoming very clear in our country that demand is outstripping supply."

Mr Bush has set up a task force, led by Dick Cheney, the vice president, to work out "...how best to cope with high energy prices and how best to cope with reliance on foreign oil". Mr Cheney sees California's woes and last year's rows over heating-oil stocks in north-eastern states and petrol prices in the Midwest as all part of one larger, looming emergency. This week, Mr Cheney held talks with Senator Frank Murkowski. Mr Murkowski's committee is about to consider an energy bill that would, among other things, open pristine bits of Alaska to the energy industry (honouring a Bush campaign promise). That meeting, says the senator gravely, "revolved around the realisation that we have an energy crisis in this country."

What nonsense. Recent volatility in energy markets bears no meaningful resemblance to the OPEC-induced pain of 25 years ago. The energy-producing regions of the world are at peace. The cartel is working with consuming economies to curb volatility in prices. Most important, as our survey of energy argues in this issue, the idea of hydrocarbon scarcity that once haunted policy debates is now largely defunct.

Supply-side economics

The administration says that California's woes are the result of an energy shortage; to fix this, more supply will be needed. In fact, California's problems are due to a badly botched "deregulation", not to any underlying scarcity of fossil fuels. Even if energy scarcity were the root of California's problem, opening Alaska to new production would not solve it: oil found there will take a decade to get to market.

The administration also believes, or says it believes, that America needs energy independence. That goal, tirelessly promoted by the domestic oil lobby, is unattainable. America's energy demands are far too large, and its energy reserves (including all of Alaska) far too small, for this ever to be achieved. That is no great cause for concern. Energy has become a global business. Security is best served by ensuring open access to markets and diversified energy supplies.

Even so, is it not mere prudence to stimulate extra domestic supply, in the name of diversification and reduced dependence? Maybe talk of emergency is overdone, but surely it cannot hurt to stimulate production with subsidies, as the administration proposes? Whether it hurts, and how badly, depends on how much money America is willing to throw away pointlessly. Some of the president's men call for an "energy Marshall Plan". That sounds costly. No such outlay is needed. Today's high energy prices have already stimulated a big rise in upstream investment.

This is not to deny any role for "energy policy". The administration could usefully push for better co-ordination of state-led efforts to deregulate electricity (some of which, happily, have fared much better than California's). On the demand side, it could promote market-led efficiency by encouraging real-time metering of all electricity use. On the supply side, it could help to curb the official greenery and red tape that have discouraged firms from building power plants, refineries and other essential infrastructure.

Measures like that would do much more to improve America's energy prospects than rushing into Alaska's wilds. Ending the false talk of crisis might encourage a more rational policy debate. It might also refute one plausible, if uncharitable, explanation for Mr Bush's zeal for energy subsidies: that he is mainly concerned with helping his oil-industry friends. Show that to be a lie, Mr President.

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Football and prune juice

Feb 8th 2001
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Soccer is a rotten business, and not just because most clubs are badly run

FROM the way football sucks in money, it looks like a fantastic business. Media companies' bids for rights have rocketed; subscriptions to pay-TV channels offering football continue to rise; clothing firms spend billions stamping their brands on the game; on February 7th, Britain's Manchester United signed what is being billed as a multi-billion-dollar joint marketing deal with the New York Yankees baseball team. Yet below the top-line figures, the world's greatest clubs look less like real businesses than does the average corner grocery shop.

This week, the world's richest football tournament, the UEFA Champions League, springs into life after its mid-winter lay-off. The 32 clubs that qualified for the competition will share over $600m of broadcasters' and sponsors' money. The winner should walk off with the best part of $40m after playing just 17 games. Lorenzo Sanz, the president of last year's winner, Real Madrid, declares that the club is "a factory to make money". Yet Real ended the season with debts of $110m, and was happy to go still further into the red in order to snatch Luis Figo, a Portuguese winger, from Barcelona for nearly $60m. Mr Sanz could more accurately have described the club as a machine for spending money.

If any football club deserves to be taken seriously as a business, it is Manchester United (see article). On any measure—revenues, profits, number of fans—it is by far the world's richest club. It is also a well-managed, listed company that nurtures new revenue streams and has an unusually good record of developing young talent. The club talks of itself as "the biggest global brand in sport" and is busily extending its "franchise" to Asia and North America. Last year United accounted for just under half the operating profit of the entire 20-strong English Premier League.

Compared with European rivals, such as Real Madrid and Lazio, until recently managed by the new England coach, Sven Goran Eriksson, United is positively parsimonious. This season, it has bought only one player to strengthen its squad, Fabien Barthez, a French goalkeeper, for about $11.5m; yet United is well on its way to carrying off its sixth Premiership title in eight years and is the bookies' favourite to win the Champions League. Lazio, which looks like being knocked out of the Champions League and seems unlikely to retain its Italian title, has spent nearly $150m.

But even cautious Manchester United suffers from the extravagance around it. Last year its profits were down 25%, largely because of wage inflation. According to the annual survey of football finance carried out by Deloitte & Touche, between 1993-94 and 1998-99, wages rose by 266% compared with revenue growth of 177%. More than half the clubs in the Premier League have wage bills that are more than two-thirds of turnover. Many are already, in effect, spending next year's TV money. Alan Sugar, who is quitting as chairman of Tottenham Hotspur in disgust, calls it "the prune-juice effect": much is taken in, but it passes quickly through.

From Hollywood to Old Trafford

In this, football is similar to other branches of show business. Yet the game does face special pressures. Any club which is not seen by its supporters to be spending every available penny on moving up the ranks risks obloquy; and with a limited pool of decent players, everyone is on a spending treadmill. Revenues go disproportionately to the winners, but in the effort to win, everyone's costs rise to, and often beyond, the winners' levels.

Soon, something is going to have to change, for it looks as though football's income from television may be nearing its peak. The broadcasters believe that coverage of football is approaching saturation point. New contracts will not provide the game with the huge increases every few years it has recently grown used to, and sponsorship too may wane. European clubs are going to have get a grip on their costs.

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America and Europe should not let missile defences come between them

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OFFENCE is seldom the best form of defence in a difference of opinion among friends. Some European officials heap scorn on America's plans for limited defences against a possible missile attack from some future North Korea or Iraq, dubbing them "son of star wars", a reference to fanciful schemes in the 1980s for an impenetrable shield over the United States. But derision won't win a hearing from the new powers-that-be in Washington, DC (see article).

In public, France, Germany and others, like Russia and China, fret that by undermining the 1972 ABM (Anti-Ballistic Missile) treaty, which limits the sorts of defences America and Russia can deploy, America could start a new arms race. These European worries should be no more lightly brushed aside than America's concerns about emerging new missile threats. President George Bush vows to press ahead with missile-defence plans. If he and his allies are to avoid a damaging rift, they need to listen to each other—not shoot from the lip.

Both can agree that the ABM treaty has brought strategic stability for 30 years. By renouncing a missile shield and leaving themselves vulnerable to each other's rockets, neither America nor the Soviet Union was tempted to attack the other, since that would invite a devastating counter-strike. This "balance of terror" allowed both to cut their nuclear arsenals. Were America now to try to make itself invulnerable to Russia's remaining rockets, Russia might try to add enough new missiles to overwhelm America's shield. Mr Bush insists his missile-defence plans will be limited enough to avoid that.

But Americans and Europeans can also agree that the threats to peace have changed. America and Russia are no longer mortal enemies. And the monopoly of the bigger powers over longer-range missiles has been broken. North Korea has a rocket that can fly far across the Pacific; it has helped Iran, Pakistan and others with theirs. Russia, whose promiscuous sales got many started in the missile business, has now offered to co-operate with NATO on less capable, more ABM-compatible, defences to counter these new threats. Even China has promised tighter curbs on its missile sales and urged North Korea to pause in its missile programme—a recognition that threats drive America's interest in defences.

The row is thus less about whether new threats are emerging, than about how to deal with them. If deterrence worked against a heavily-armed Soviet Union, ask sceptical Europeans, why would it not work against a roguish regime with just a handful of rockets? America, the country they look to in a crisis, worries differently: that sooner or later it will find itself toe-to-toe with a risk-defying regime bent on aggression that could threaten a nuclear, chemical or biological strike against America's bases abroad or its citizens at home. Such vulnerability could invite the miscalculation that aggression can pay. By building limited defences, America argues, it would not be abandoning other tools—from diplomacy to deterrence—but strengthening them by making life harder for a troublemaker. That is just as well, since ballistic missiles are not the only threat to be dealt with—albeit a particularly potent one.

From deterrence to...discussion

Yet there is good reason for everyone, including America, to be cautious about missile defences. Ambitious plans—especially ones that count on putting weapons in space—could provoke an arms race that would leave everyone worse off. Some American officials talk enthusiastically of sea-based systems

that, rather than upsetting the ABM treaty by putting a shield around America, could be moved to deal with likely threats closer to source, thereby posing less of a problem for Russia or even China, with its smaller deterrent force. Mr Bush, meanwhile, has sought to reassure allies by insisting he will look to their security, not just America's.

But whether or not defences of one sort or another are in theory the right answer to the new threats facing America and its allies, in practice there is another problem: none of the technologies needed to make them work is yet proven. Recent tests of land-based defences have failed. Sea-based versions being talked of are even further off. If missile defences can be made to work better, and can be deployed in stabilising, not destabilising ways, probably more countries will become interested in them. But no technology can ever be certain of working perfectly. In a dangerous world, America and Europe will still need each other as close allies. As Mr Bush ponders his missile-defence proposals, and Europeans ponder how to react to them, both would be foolish to let their differences over this issue come between them.

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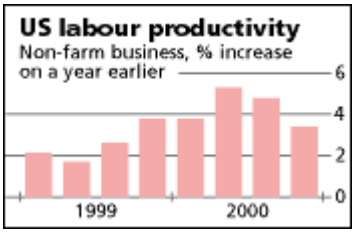
Productivity, profits and promises

Feb 8th 2001
From The Economist print edition

Will America's "new economy" survive the downturn?



IN JUDGING an economy's prospects, what is the most important measure? Growth in GDP? Inflation? The size of the budget surplus? The level of the stockmarket? None of the above. Far more important is growth in productivity, which is crucial in itself and which affects all of those things and more. The surge in productivity in recent years has been a key element in America's virtuous economic circle. Faster growth in productivity allowed faster growth in GDP with low inflation. This, in turn, boosted profits and share prices and encouraged more investment, which further lifted productivity. Whether or not firms can sustain their faster productivity gains is, therefore, a far more important question than when the Fed will next cut interest rates.

New figures this week showed that growth in America's labour productivity slowed to an annualised 2.4% in the fourth quarter of last year (the year-on-year increase slowed to 3.4%, from 5.3% in the second quarter). This implies an acceleration in unit labour costs, which are now rising at an annual rate of more than 4%, up from zero six months ago. This will dent profits and might yet limit the Fed's room to cut interest rates. But what do the new figures say about the long-term rate of productivity growth? Productivity growth surged to an annual average of 3% in 1996-2000, compared with 1.4% in 1973-95, but economists remain divided about whether this can last. The leading sceptic, Robert Gordon, an economist at Northwestern University, has argued that most of the increase in productivity growth outside information-technology industries has been cyclical, the result of the economic boom. In contrast, the Clinton administration's last "Economic Report of the President" claimed that virtually all of the increase since 1995 has been "structural".

Optimists accept that productivity growth will temporarily dip in a downturn, but they expect the trend of rapid growth to persist. Sceptics expect productivity growth to slump. One quarter's figure cannot settle the matter. The increase in productivity in the fourth quarter was stronger than expected, given that growth in GDP slowed so sharply. But the slowdown in productivity growth even before the economy has moved into recession does cast some doubt on how much of the previous increase is lasting. It is hard to believe that none of the jump in average productivity growth since 1995 was cyclical. During that period unemployment fell and the current-account deficit tripled, suggesting that output was growing faster than the economy's productive potential.

Teaching a new economy old tricks

How productivity holds up will depend partly on how firms adjust investment and jobs to a slowdown (see article). In the "new economy", firms are supposed to behave differently. For instance, it used to be argued that IT investment would be relatively immune to the cycle. In fact, firms are already cutting their spending plans. Total business investment fell in the fourth quarter for the first time in nine years.

Companies, equipped with fancy computer systems and instant information, were also supposed to be able to avoid an excessive build-up in inventories. Yet, as sales have slowed, stocks have continued to grow rapidly. Computerised systems have allowed firms to reduce their stocks, but have not eliminated big swings. Stocks have risen sharply over the past year, by more than at any time since the recession of the early 1990s, making cuts in production inevitable. In the past, firms have also been slow to shed workers during the early stages of a downturn, causing productivity to slump. In the new, more flexible economy, it is argued, firms can cut labour more swiftly. So far, firms have mainly trimmed working hours, not jobs. The snag is that this fails to cut fixed costs.

With profits already falling, firms will be forced to cut inventories, investment plans and workers.

Optimists still maintain that IT and more timely information will help firms to adjust swiftly and so help to smooth the cycle. But the paradox is that the more swiftly they do this in a bid to improve their individual performance, the deeper will be the drop in output and profits in the economy as a whole.

That many “new economy” claims look flawed does not necessarily mean that all are. There is evidence that structural productivity growth has quickened, but not as much as is widely believed. Those who think that productivity growth of 3% or more is sustainable are saying that IT will have a bigger economic impact than the era of electricity and cars in the 1920s. That was, and remains, a bold claim.

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Why Japan's Mori must go

Feb 8th 2001
From The Economist print edition

As long as Japan retains Yoshiro Mori as its prime minister, heading a government of dinosaurs, it will drift towards trouble—even, perhaps, towards disaster

Reuters

IT IS a country that once felt great and proud, and now feels rather glum and second-rate. It is a country that has suffered a decade of economic stagnation, that in the past few years has zig-zagged in and out of recession, and in which unemployment has climbed to worrying levels, having for decades been virtually unknown. It is a country that faces the prospect of political change on its doorstep if the two Koreas continue their thaw, and political challenge in its region if China continues its growth. But it is also a country whose banks and life insurance companies, repositories of much of the nation's savings, look either weak or plain insolvent. That, in turn, makes it a place that could be knocked flat on its back if there were to be some sort of worldwide economic downturn, particularly one originating in the United States, the biggest single market for the country's exports.

The country is, of course, Japan. To any political analyst with a sense of history, the circumstances just outlined should make Japan look a perfect candidate for some sort of extreme political change. Yet few seem to take such a prospect seriously, particularly inside Japan itself. The country has been so stable, and docile, since the days of communist demonstrations in the 1950s and wild student punch-ups in the 1960s, that it is hard to imagine anything very lively. It has been ruled virtually by a single party ever since 1955. Its voters have taken every disappointment of the past decade on the chin, becoming apathetic rather than angry. Most likely, things will stay that way. But there is a danger that they will not. And that danger increases the longer the current prime minister, Yoshiro Mori, remains in office, and the longer the country's political paralysis endures.

The limits to patience

For a decade, the political establishment has failed to find a way to pull the country out of its economic treacle. In such circumstances, all it would take to open the way to demagogues and other sorts of political faith-healer would be a fresh economic crisis, one harsh enough to make voters fear that treacle was turning into quicksand. And, if the worst really did come to the worst on Wall Street and in the American economy this year, such a crisis could be only months away. Yet Japanese politics stumbles on, in its usual corrupt, complacent and ineffectual way.

This week an opinion poll in the *Mainichi* newspaper found that the approval rating for the government led by Mr Mori had fallen to a mere 14%. The main stockmarket index in Tokyo, the Nikkei, is nearing its lowest levels since early 1986, underlining the lack of confidence in Japan's supposed economic recovery, and bringing the many banks that depend on shareholdings for their capital base closer to the brink. New GDP figures released on February 8th suggested that the economy has barely been growing during the past six months. An election for the upper house of the Diet (parliament) is due in July, and the governing coalition, led by Mr Mori's Liberal Democrats, looks destined to suffer a heavy defeat, losing the majority in that chamber which is crucial if it is to get its legislation on to the statute books.

So is the government contemplating a change of policy, or a change of prime minister, in order to rescue both itself and the country from disaster? There is little sign of it. To a degree, this is not terribly surprising. As wags have said, Mr Mori may be one of the worst Japanese prime ministers in living memory, but his job is nevertheless one of the safest in the country. No one wants to take on this poisoned chalice, at least until after the upper house elections in July. One who tried to do so late last year, a bright reformer called Koichi Kato, proved not bright enough to carry his erstwhile supporters

with him, and is now in the political wilderness.

Probably, after that upper house defeat, the Liberal Democratic Party (LDP) will at last change its leader, and thus prime minister. It may even choose someone with some vim and vigour, with a bent for reform. But it will make little difference, for with no majority in the Diet, the government will be unable to achieve very much, particularly as many heavyweights in the LDP themselves oppose change. There might be the appearance of renewal, but not the reality of it.

What needs to happen instead is for this government to be brought down in a vote of confidence, after which elections could be held for both houses of the Diet, or else a new government could be formed. There is little sign of that either, although the opposition parties do have the governing coalition on the ropes over several corruption and campaign-finance scandals. The trouble is that the opposition, too, is far from clean, and not terribly united. The various opposition parties, led by Yukio Hatoyama of the Democratic Party, have talked about running on a unified ticket in July's election, but even that is not yet certain.

And the alternative? So far, the stirrings are faint. But there are signs of a new, more defensive, more negative sort of nationalism, replacing the proud, more positive sort of recent decades. Calls for protectionism against imports from China are on the rise, despite Japan's huge overall trade surplus, as are pressures for a more hawkish approach to that traditional regional rival (see article). So far, this is all within the normal range of democratic politics and policy discussions. But the risk is rising that Japan will not stay normal forever.

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Letters

Feb 8th 2001
From The Economist print edition

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Reform schools

SIR—Understandably, you question whether George Bush has the courage of his convictions on education reform ("Education betrayed", January 27th). However, it is too early to dismiss Mr Bush's approach as feckless. He has called for a range of corrective actions against laggard schools, including their conversion into public charter schools run by education entrepreneurs. And though he may not use the V-word, vouchers in effect remain in his plan. Against the voucher naysayers, Mr Bush could build an effective coalition with inner-city parents and black leaders like Andrew Young, a former UN ambassador, who realise that freedom of choice is the civil-rights issue of the 21st century.

ROBERT HOLLAND
Lexington Institute
Arlington, Virginia

SIR—George Bush asserts that education is his first priority. An encouraging sign. He should start with his own immediately.

MATT SIMON
Boston

In the pipeline

SIR—Your article on ambitious natural-gas pipeline plans in South-East Asia ("Pipe dreams", January 20th) neglects to mention what an absurd, tragic failure the Yadana pipeline from Myanmar to Thailand has been. Forced through by Myanmar's junta, and Total and Unocal, this project has actually raised the price of electricity for Thai consumers, and caused environmental damage on both sides of the border. Court documents tell of forced relocation of indigenous people and their use as slaves in operations to secure the pipeline's route. Oil companies should think twice before playing "join the dots" between Asia's rainforests and war zones.

EDITH MIRANTE
Portland, Oregon

Toeing the timber line

SIR—Your article on the Malaysian logging industry is amusing ("Good fellers", January 27th). First, it states all the sins that we practice: over-logging, greed, refusal to adopt international standards on managing forests, violation of the rights of indigenous peoples, corruption, etc. Then, in cloak and dagger style, it "reveals" that the country now wants to adopt the Forest Stewardship Council's green standards because Malaysia's prime minister ("ever a proud opponent of western values") "may have realised at last that being green pays well." Consumers in the West "will pay as much as 50% more for certified stuff." Certification to FSC, just for money, plenty of money.

Contrary to what you say, there are no FSC "standards". The FSC promotes principles which need to be translated into aspects of economic, social and environmental performance in the way forests are managed, adapted or modified as appropriate to each country's circumstances. And they are certainly not "western values". What western values can we look up to in Europe's decaying ecosystem? The World

Wide Fund for Nature is quoted as stating that “less than 2% of Europe’s forests are left in their original state.” What is left “is under threat from axe, fire, pollution and urban sprawl, and little is being done about it.”

AIMI LEE ABDULLAH
Malaysian Timber Council
Kuala Lumpur

Unhappy partners

SIR—Your article on biotechnology alliances talks of them as a renewed proliferation of partnerships in drug discovery (“Rites of passage”, January 20th). This trend, however, is somewhat curious given the high reported rates of failure for these types of ventures. Failure rates have been estimated, even recently, at 40% by PricewaterhouseCoopers, at 50% by McKinsey and at well over 60% by Andersen Consulting.

This poses a legitimate question. If the chances of failure are higher than those of succeeding, why is time and effort still invested in biotechnology partnerships? And, given that such alliances are designed and managed by very capable scientists, why are they not better at so simple and natural a task as co-operating? Or, to invoke the American question, “If we’re so smart, why aren’t we rich?”

MARK DE ROND
Paris

Freedom of speech

SIR—Your article on Hong Kong’s declining standard of English (“In Hong Kong they must be kayu”, January 20th) displays a lack of understanding of the difference between a monolingual society such as Hong Kong and a multilingual one like Singapore. Also, you have totally misused the Singlish terms: *shiok* connotes a sensory satisfaction equivalent to the American “awesome”; *obiang* means “in bad taste” and has nothing to do with “bad” English; and *kayu* means “blockhead”, and only that. Singaporeans live with a variety of languages, including dialects of various ethnic groups. Since the 1970s English has become the *lingua franca*. Our casualness with the language should not be a surprise.

CAMPBELL LEE
Singapore

SIR—You are absolutely right that there has been a general decline in our proficiency in English in Hong Kong, but you have not noticed the root cause. We are unlearning dignity, compassion, patience, manners, endurance, adaptability, a sense of responsibility and much more. It is unfair to tie the drop in “civility” to the handover to China; the trend was clear even when Hong Kong was under British rule. Doting parents and an irresponsible education system which covers nothing but techniques for taking exams are more to blame.

WILLIAM KWAN
Hong Kong

Practical philosophy

SIR—One of the greatest pleasures in my life was staying up with Willard Quine (Obituary, January 13th) late into the night while he drew deep conclusions from the observation that “snow is white”. But I am surprised to read that “Mr Quine has no important theorem to his name.”

While he was a student at Harvard he wondered if there was an algorithm that could simplify logical expressions. His solution to this puzzle sat on the shelf for many decades, until very-large-scale integration circuits came along. What is now known as the Quine-McCluskey minimisation algorithm became an essential element of the electrical engineer’s toolbox for minimising transistor count. He took great pleasure that what he thought was an abstract philosophical question could have such practical implications.

NEIL GERSHENFELD
Cambridge, Massachusetts

The Clinton effect

SIR—Your chart showing that only states in which Bill Clinton had a 57% or greater approval rating voted for Al Gore does not lead to the conclusion that Mr Clinton's campaigning for Mr Gore would not have helped him ("Al, it wasn't your fault", January 27th). You state that it is apparent that if Mr Clinton's appearance on the campaign trail had driven his overall ratings down by a point or two, Mr Gore would have lost by a landslide. But, what if your assumption that his appearance would have lowered his ratings is false?

After the election Mr Clinton broke his silence and began trumpeting the successes of his administration. His popularity ratings rose. Seeing the cluster of states between 55% and 57% it is clear that if Mr Gore had ridden on Mr Clinton's coat-tails so that people in states with a 55% rating voted for him then he would have won by a landslide. Similarly, even if Mr Clinton did not campaign, had Mr Gore more closely aligned himself with the Clinton administration he might have taken advantage of Mr Clinton's popularity and obtained extra votes. I read the chart to demonstrate that Mr Gore should have taken all the states where Mr Clinton's popularity rating was 50% or higher. This would have led to an enormous victory. Any state, such as Tennessee or Arkansas, with a rating over 50% was Mr Gore's to lose. And he did—big time.

ROBERT WILSON
Tiburon, California

Thai Rak Thai reply

SIR—Your leader on Thaksin Shinawatra, prime minister-elect of Thailand, was curiously inaccurate ("Tycoon or Thai con", January 13th). You say that "the biggest worry about Mr Thaksin and his party is that he shows no sign of the commitment to political reform that was the hallmark of Chuan [Leekpai]", his predecessor. This is nonsense. Tell any Thai that Mr Chuan stood for what you call "reformist zeal" and they will laugh. The lack of reform under Mr Chuan was one of the key reasons that voters rejected him. By contrast, Mr Thaksin's Thai Rak Thai party was the first party ever in Thailand to run on a platform of reform policies, which in large measure explains why he won so resoundingly.

You cite as an example of Mr Chuan's commitment to reform that he established anti-corruption and electoral commissions. Both of these were mandated by Thailand's new constitution, not initiated by the Chuan government which was constitutionally obliged to pass them.

The article states, "Thaksin has shown no such zeal for clean politics", claiming he "snubbed" the corruption commission investigating his affairs and then "rejected its findings." The National Counter Corruption Commision (NCCC) functions like a grand jury. All its findings are subject to confirmation by the constitutional court. The NCCC investigated allegations that Mr Thaksin concealed assets in a statement filed when he was deputy prime minister in 1997. Mr Thaksin submitted reams of evidence to the commission and appeared before it to answer questions once its members had examined the pertinent files. The assets in question amount to 3% of Mr Thaksin's net wealth, which he had no need nor intention to conceal. There are many questionable aspects to the NCCC finding against Mr Thaksin and he is confident that he will be vindicated when the case appears before the full court.

It is also wrong to suggest that under Mr Thaksin "Thailand may be about to swing in [an] anti-western direction." Mr Thaksin, along with many around the world, including the World Bank, does not agree with all prescriptions of the IMF. To infer from that that he is anti-western is unjustified. Thailand has always been open to the West and under Mr Thaksin will remain so. The title of the article may have been an amusing pun but the content was seriously lopsided. It is precisely because Mr Thaksin proposes long-needed reform that he and his party won a mandate unprecedented in Thai politics.

SURANAND VEJJAJIVA
Spokesman, Thai Rak Thai
Bangkok

Net regulation

SIR—You perpetuate the myth that "the reason the worldwide network became such an innovative force at all was a healthy mix of self-regulation and no regulation" ("Stop signs on the web", January 13th).

Not having to ask anyone's approval to build on the Internet has surely contributed to its being a platform for profound innovation. However, this has had less to do with regulatory restraint than Internet architecture, which implicitly embraces a key regulatory concept: it does not discriminate among networks or users. This feature, a product of the non-commercial culture which prevailed among the Internet's original designers, is both a strength and a weakness. It is now at risk of being compromised in many ways. As you recognise, "the demands of e-commerce, rather than governments, are driving improvements" to the Internet's architecture.

While these changes are neither inherently good nor bad, they should be considered issues of global public policy given the importance of the Internet to global communications. Public regulation may, in some cases, be needed to translate implicit design principles into enforceable Internet policy. The approach of America's Federal Communications Commission to instant messaging is an example of just this kind of process. Portraying Internet policy as a "struggle between freedom and state control" ignores the reality that state action is often what guarantees freedom. That is no less true in cyberspace than in the real world.

CRAIG MCTAGGART
Toronto

The educational divide

SIR—When I left Northern Ireland 30 years ago, a divided educational system was one of my reasons for going ("Selecting for the best", January 20th). With this system still in place it is little wonder that each new generation remains at best suspicious of and at worst openly hostile to the other community.

Although laudable, slightly better exam results than those in England pall into insignificance beside an outmoded and divisive education system, which successive governments have not dared to disturb. To describe it as "more socially inclusive than that in the rest of the United Kingdom" is beyond belief. Northern Ireland's education system is still mired with the deepest of divisions.

VICTOR HOBCROFT
Jakarta

SIR—Your espousal of grammar schools, and citing of Northern Ireland as proof of their effectiveness, is a classic example of confusing correlation with cause. You concentrate on one variable that suits your prejudices and do not examine whether other differences between Northern Ireland and the rest of Britain might be the cause of improved performance. If grammar schools were as useful as you suggest then other areas of Britain that retain grammar schools should be significantly better than the rest of Britain too, but this is not the case. You do not consider this and yet you recommend selection as the course to follow.

Spending per pupil in both Northern Ireland and Scotland is higher than in England. Could this have an effect on performance? You do not seem to be advocating levelling the spending between different parts of Britain. The side-effects of Northern Ireland's religious segregation may be increased competitiveness between schools and increased discipline within schools. Why not advocate that all of Britain should move towards religious segregation? Northern Ireland has a lower income per head than the rest of Britain, which could encourage people to study to improve their position. You do not recommend lowering incomes in the rest of Britain.

J.C. BOFF
Pinner, Middlesex

Rights of the hunter

SIR—Bagehot (January 20th) falls firmly into the pro-hunting camp on a pretext that "the line must be drawn somewhere." Quite right—except that his line is arbitrary and short-sighted. Bagehot cites bear-baiting, foxhunting, shooting and fishing, laboratory testing, and rearing for slaughter as animal-rights issues. These actually fall into two categories: those which are sports and those where the deaths of animals are unhappy and unpleasant consequences of human welfare where (one hopes) no pleasure is attached to killing.

Bagehot maintains that the welfare of the fox is the primary driver behind the debate. However, I would

urge him not to dismiss the “spiritual welfare of the hunter” so readily. For that which is deemed a civil liberty changes. Our past is littered with examples of the liberties of a less enlightened age. Any form of governance, through legislation, shackles our freedom of action to a greater or lesser extent. The consciousness that facilitates any sort of code of ethics is what distinguishes us from the fox and his brethren. The dynamic evolution of this code is at least as important as any other form of progress; it must continue.

DAVID EDWARDS
London

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Keeping friends

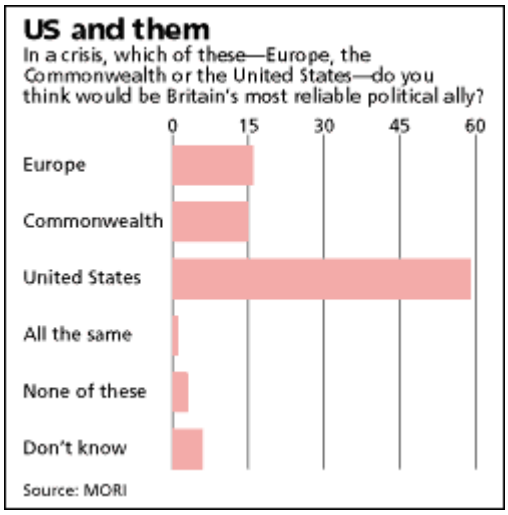
Feb 8th 2001 | BRUSSELS AND LONDON
From The Economist print edition

Tensions between the new American administration and the European Union over defence could put Britain in a pivotal position. Britain may not find that a comfortable place to be

EVEN before George Bush was in the White House, the British government was rushing into print to affirm that Britain's "special relationship" with the United States would not be affected by a change of president. In an article entitled "It could be the start of a beautiful friendship", Robin Cook, Britain's foreign secretary, argued that the United States would remain Britain's "closest ally and our biggest export market." This week Mr Cook was in Washington, meeting Colin Powell, America's new secretary of state, in an effort to get the new relationship off on the right footing. Before the end of the month Tony Blair will also travel to the United States to meet Mr Bush.

The British urgency betrays a certain nervousness. It is not just that New Labour felt ideologically more comfortable with Bill Clinton and the Democrats. It is also that developments in the triangular relationship between Britain, Europe and the United States threaten to undermine one of the basic tenets of British foreign policy—that there is no choice to be made between a close relationship with the United States and the intimate relationships entailed by Britain's membership of the European Union.

Mr Cook insists that it is an "anti-European myth" to suggest that such a choice might exist. He asserts that "any loss of influence in Europe would damage our economic relations with the US, and our strategic relations." In other words, Britain strengthens its voice in the United States only by playing a full part in the EU. But could that change?



The question has been raised in recent months by shifts in the political and strategic debate on both sides of the Atlantic. Up to now, part of the transatlantic bargain has been that Europe and America deal with one another as equals, closely intertwined but occasionally quarrelsome, in economics; whereas in defence questions the Europeans—albeit sometimes tardily and reluctantly—follow America's lead. This division of labour made it possible for Britain to be a more-or-less dutiful European over many economic questions (which sometimes meant taking the Union's side in disputes over aircraft subsidies or carbon emissions) while remaining loyal to America in the areas of defence policy that really count.

Certain elements in this careful balance are now changing. On the one hand, the European Union—long dismissed as an economic giant and a geopolitical dwarf—is sounding more serious about turning itself into a real force in world affairs, with a role to play in "security" as well as economics. In particular, the Union now wants to become more effective at "crisis management"—a term that can mean anything from sending a few aid workers to a war zone to the use of military force. The appointment of a senior politician, Javier Solana of Spain, to personify the Union's external policy is a token of the EU's desire to speak with a louder, though not necessarily anti-American, voice. So far, there is little to show for this effort, except in the Union's immediate neighbourhood; but the EU's declared intention to exercise a bit

more influence has already changed the transatlantic mood.

At the same time, some of the hardest strategic heads in the United States are suggesting that the Asia-Pacific region, and possibly the Gulf, rather than anywhere in Europe will pose the toughest challenges to American security in the years to come. This does not imply that America has any intention of disengaging from the defence of Europe. But it may mean that the terms on which America remains engaged will grow tougher, and there will be less patience with what seems, from an American viewpoint, like petty posturing or point-scoring by the Europeans. The resulting squabbles will be harder for Britain to finesse.

It is against this rather inauspicious background that the Union, late last year, produced the first tangible result of its efforts to become a serious player in the arena of international security. This was a formal agreement to create—albeit largely on paper—a 60,000-strong military force which could be assembled rapidly and sent to a distant trouble-spot for up to a year.

Tony Blair had invested a good deal of personal authority in this, believing at first that it could serve to nip transatlantic squabbles over burden-sharing in the bud while allowing the Union to acquire a small, but from America's viewpoint harmless, degree of independence. For Mr Blair, Euro-defence also offered a way to demonstrate Britain's central role in the Union at a time when its commitment is being questioned because of the country's reluctance to join the euro, the single European currency. In the language of his friend Bill Clinton, this would have been a win-win-win outcome.

Yet the new American administration seems less confident than its predecessor that European muscle-flexing can be kept within harmless limits. Donald Rumsfeld, the new American defence secretary, told a security conference in Germany at the weekend that he was "a little worried" by European plans for greater military independence. "Actions that could reduce NATO's effectiveness by confusing duplication, or by perturbing the transatlantic link, would not be positive," he said. Unless these anxieties can be allayed, Mr Blair may find himself squeezed by competing pressures from his European and American allies.

So far at least, transatlantic squabbles over European-only defence operations have been more about impressions than reality. Even if Europe's hopes of acquiring the capacity to sustain a 60,000-strong force are fulfilled, there is no real challenge to American-led NATO as the main guarantor of European security. A more substantial issue is posed by the Bush administration's keenness to deploy missile defences to shield America's own territory against rogue attacks, to protect American bases overseas—and possibly also to shelter the territory of allies.

Several prominent European figures, particularly in France and Germany, have already made it clear that they regard the Bush administration's plan as ill-conceived and destabilising. Tony Blair will be put in a particularly tight spot if, as looks likely, the Bush administration asks for permission to upgrade the Fylingdales radar station in Yorkshire as part of an anti-missile defence system. His European allies will press him to refuse, or at least parry, the American demand. But if Mr Blair is asked point-blank by an American president to co-operate, could he really say no? So far, the British government is stalling—although Mr Blair is thought to incline privately to acquiescing in Mr Bush's request, if and when it is made.

These defence questions are the sharp edge of the most sensitive issue in Britain's foreign relations. Will the United Kingdom's membership of the European Union—with its self-proclaimed goal of "ever-closer union"—ultimately imperil its special relationship with the United States? It is a question that matters far more in London than in Washington. Yet Britain's future in Europe, and its consequences for its relationship with the United States, may also come to matter in Washington. Little doubt exists that there are voices within the European Union that expect (indeed, long for) a growing foreign-policy rivalry with the United States. If that emerged, the position of Britain would be both ambiguous and pivotal.

Anatomy of a friendship

The phrase "special relationship" is used far more in Britain than in the United States. When prominent Americans hear Britons use the term, they can be forgiven for looking slightly blank. The United States, with global interests and a polyglot population, has "special relationships" with many countries round the world. Arguably, its relationships with Israel, Japan, Mexico and Canada are as special as any with the United Kingdom.

It is also true that the relationship—forged during the first and second world wars—used to be a lot more "special". But despite Britain's diminishing global importance in the post-war years, it remains true that there is a special quality to its friendship with the United States in four particular areas. One, the most amorphous but perhaps the most tenacious, is historical and cultural. The other three are all defence-related, concerning intelligence, nuclear affairs and military matters.

This makes difficulties over NATO and anti-missile defences all the more awkward. The closeness of British intelligence ties with the United States continues to excite suspicion in the rest of the European Union. In recent months, for example, the European Parliament has been much exercised by the idea that the United States is committing large-scale commercial espionage through a satellite system code-named Echelon. The parliament has heard testimony that Echelon relies on satellite stations based in Britain. One French member of the European Parliament, Jean-Claude Martinez, fulminated that this proved that "Britain's real union is with America." Whatever the truth or otherwise of the Echelon allegations, Britain certainly shares intelligence with the United States, Australia, Canada and New Zealand that it does not share with its European allies, and has done since 1947. James Woolsey, a former director of the CIA, says that "although no one is a complete friend in the intelligence world, with Britain and America it is as close as it gets."

The closeness of the intelligence relationship is linked to Britain's nuclear relationship with the United States. Along with its permanent seat on the United Nations Security Council, Britain's possession of a small nuclear deterrent has been crucial to its claim to be more than just another middle-ranking power. Unlike France, which has insisted on developing its own nuclear *force de frappe,* Britain has been happy to buy all its Trident nuclear technology from the United States. Additionally, as two of the five "status quo" nuclear powers, Britain and the United States have had a shared interest in working together to block nuclear proliferation.

Intelligence and nuclear weapons lead naturally to the third element—close military and diplomatic co-operation. This was on display, of course, for much of the last century. The two countries were again close military allies during the Gulf war. Despite considerable differences over the handling of the conflict in Bosnia (America was covertly supplying weapons to the Bosnian army even as that army fought pitched battles with British and French peacekeepers around Sarajevo), Britain and America were once again in close harness by the time of the Kosovo campaign. Since the Gulf war of 1991, America and Britain have never ceased to co-operate closely in keeping a tight noose around Iraq—through bombing raids, sanctions or UN votes. While Britain's military contribution to this effort has been minor, its constant presence at America's side has been an important source of moral support and legitimacy.

The hinge of the Anglo-American military relationship in the post-war years has been NATO. That is why Mr Blair and his colleagues have been so keen to insist that the new EU military wing is intended to complement NATO, not to undermine it. Britain—which has offered to put more than 12,000 troops, an aircraft carrier and an amphibious brigade at the disposal of the nascent European force—insists that NATO will continue to be Europe's major security club and will retain its position as the main agency for military planning, even for European operations. The EU force will act only when NATO as a whole decides not to get involved. As such, argue the British, the European force will further an important goal of American foreign policy: that Europe take on a greater share of the burden of its own defence.

Not all Britain's European allies, however, share its limited view of the role of the new force. Romano Prodi, the head of the European Commission, has let slip that he regards it as a European army in embryo. And the French in particular clearly want the European force eventually to act as the military arm of an independent European foreign policy.

British Eurosceptics have rushed to raise the alarm that this "European army" will undermine NATO and drive a wedge between Europe and the United States. For many members of the Conservative Party, the issue is heaven-sent. They are suspicious of deeper European integration in all its forms, and have looked to the United States as an alternative to the European Union. Some have been trying to push the idea that Britain should join the North American Free-Trade Agreement. But, despite some interest from a couple of Republican senators, the idea that Britain should join NAFTA is not yet taken seriously in the United States.

Many Tories clearly see an opportunity in matching American anxiety about the future of NATO with

British anxiety about the future of the EU. A just-published book called “Stars and Strife: The Coming Conflict between the USA and the European Union” by John Redwood, a right-winger who once ran for the post of leader of the Tory party, argues that Britain will face a crisis of loyalty sooner rather than later; and he has no doubt which friend it should plump for.

For a long time there was little public evidence of any such American worries about Europe’s military initiatives. In a joint article with Robin Cook late last year, Madeleine Albright, then secretary of state, declared her support. But little more than a week later William Cohen, the then secretary of defence, remarked in Brussels that NATO risked becoming “a relic,” if the EU tried to develop its own military capabilities.

It is clear that some prominent Republicans are worried. Richard Perle, an adviser on defence to the Bush campaign, described the European defence initiative as “French manoeuvres aimed at sidelining the United States in Europe.” Senator Gordon Smith, the Republican leader of the Europe subcommittee of the Senate Foreign Relations Committee, told a British audience last year that he suspected that the EU’s real motive in building the force was to check American power, and urged the British to “never forget the vital British role as the linchpin in the Atlantic alliance.”

Clearly Mr Smith’s views do not represent the entirety of Republican opinion, let alone American opinion. For many years, support of closer European integration has been a fairly settled bipartisan policy in the United States. Both General Powell and Condoleezza Rice, George Bush’s national security adviser, are keen on greater military burden-sharing. (And General Powell seemed blissfully happy as he met Mr Cook this week, declaring Britain and America “strong friends, staunch allies, forever into the future.”) Robert Zoellick, America’s new trade representative, has also been an eager supporter of closer European integration. These folk might well take a more relaxed view of the European defence initiative.

The uneasy European

Much will depend on how these issues are worked out in practice. If the more ambitious French-inspired visions of a European military force, with its own autonomous planning staff, gain ground, that will be a recipe for trouble. Britain might even be forced to rethink its commitment to the whole idea. An important subsidiary issue that will have to be resolved is the need to reconcile Turkey—a key member of NATO, but kept at arm’s-length by the EU—to the new European defence arrangements. The Americans seem sympathetic to Turkish anxieties, while the Europeans will be extremely reluctant to give the Turks a veto over their military ambitions.

The whole debate also has to be seen in the wider context of Britain’s uneasy relations with the EU. Much of Britain’s foreign-policy establishment believes that the choice between the EU and an “Anglosphere” of the United States and the Commonwealth countries was irrevocably made in the 1970s, when Britain joined the EU. So, despite Britain’s palpable unease with the steps the Union has taken towards greater political integration, it would still require a fundamental change in British thinking for the United Kingdom to make a deliberate attempt to draw away from the European orbit, and closer to the United States. Only a crisis in relations with the European Union—perhaps an irreconcilable argument over the pace of European integration—might provoke such a shift. For this crisis to force a change in policy, it is likely that the fundamentally pro-European Labour Party led by Mr Blair would have to lose power to the Tories.

The decision would not be Britain’s alone. Might it be conceivable that the United States would encourage such a move, perhaps by floating the NAFTA option? Again, such a development would require a big shift in American thinking. In particular, America would have to become much more wary of European political integration, and of the EU’s foreign-policy and military pretensions in particular. That, in turn, would probably require three things: that the more ambitious French view of the European military force’s future role had prevailed; that the Republicans would still be in office; and that the Eurosceptical wing of the Republican Party would be in the ascendancy.

It still seems highly unlikely that all these factors will come together and that the relatively stable pattern of the past 30 years will be disrupted. Most probably, Britain will continue to become more closely enmeshed in the European Union, with the continuing support of the United States, and consequently the significance of the special relationship will continue its gradual decline. But the idea that Britain has a fundamental choice to make between the United States and Europe is still too melodramatic at the moment. Instead, as a major review of Britain’s defence strategy pointed out this week, Britain’s most important role may well be to prevent misunderstandings between the two sides, while staying friends with both.

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California on the couch

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From The Economist print edition

Power cuts, the dotcom bust, a strike in Hollywood, Tom and Nicole splitting up: no wonder California is having a bout of self-doubt

GLOOM. It's what you get when the lights go out, and California is succumbing fast. After euphoria at the crest of America's boom, the home of the new economy is in a funk. Power cuts, with the threat of worse to come when the summer heat brings on the air conditioning, have embarrassed the state at a time when Silicon Valley and Hollywood are going through troubled patches, and when familiar doubts about California's creaking infrastructure are re-emerging.

California, which became a state in 1850, just after the gold rush fired the imagination of America, has always surged between joy and despair. In the early 1990s, east-coast magazines crowed that the Golden State's best days were behind it. The end of the cold war had crushed the aerospace industry, tipping the state into recession and prompting an anti-immigrant backlash. Earthquakes struck in 1989 and 1994, and riots blazed through Los Angeles in 1992 after police officers who beat a black motorist were acquitted. Yet since 1995 the state's economy has grown by 32%—nine percentage points faster than the national average.

So far, the economic cost of the electricity crisis for the state at large has been small. Rates have not gone up for most customers (which is part of the problem for the utilities) and there have been only a few 90-minute interruptions in power. The toll on morale has been much higher, though. Half the population of the state, according to a recent Field poll, is pessimistic about the way it is heading. The popularity of Gray Davis, the governor, has taken a hammering.

Los Angeles is symptomatic. The city has been spared the direct effects of the electricity mess, because it has kept its local utility in public hands. (It will eventually suffer indirectly, because state revenues that might have gone to maintaining roads and schools will go towards paying for electricity.) But the power crisis taps into general frustration with local-government services.

The federal government has stepped in to oversee the Los Angeles Police Department after revelations of framing and even the murder of suspects by an anti-gang unit. The city's school system, among the worst of a bad lot through the state, is full of squabbling. The San Fernando Valley, covering almost half of the city, is the largest of several districts that want to break away from Los Angeles and form new cities.

Normally, the city could take some pride in its private sector. But Hollywood is panicking too, shooting films and television series as fast as it can before actors and writers probably go on strike in May over contract renegotiations. (The issue is partly to do with cash, but there is also a self-esteem question: the writers want more credit.)

Reuters

In the north of the state things are hardly any better. The latest dotcom star to sputter out, eToys, announced this week that it would lay off its 293 remaining employees and close in April. Bigger Silicon Valley firms have also been firing workers. Up in Napa Valley the wine industry is worried by a troublesome insect, the glassy-winged sharp shooter, and the water on which the Central Valley's farmers depend looks likely to be in short supply for the next few years.

Once again, poor government services are part of the problem. Throughout the Bay Area, traffic jams throttle movement. House prices, though starting to fall, remain high enough to drive away many old residents of San Francisco and to

feed resentment in poorer neighbourhoods. The city's pet-loving Bohemians are obsessed by the horrible death of a woman mauled by a mastiff. The dog turned out to have been bred to protect illegal drug laboratories on the orders of an imprisoned white supremacist.

It's in the stars

So far, Mr Davis's response has stuck to the ritual. He has blamed outsiders, railing against "out-of-state profiteers" for precipitating the power crisis (just as his predecessors 100 years ago blamed Chinese labourers for spreading disease, and ten years ago blamed illegal immigrants for causing unemployment). More helpfully, the state has intervened to buy long-term electricity contracts to sell on to the less creditworthy utilities, although that still looks something of a stopgap measure.

Behind the power crisis lurk two bigger issues. The first, as ever, remains inadequate infrastructure. Electricity transmission will be a problem even when enough of the stuff is finally generated. Water reserves are low—one more dry winter will mean a certain drought in 2002. The great achievements of the Progressive era, transport and education, are being overwhelmed; the environmental struggle between sprawling suburbs and farmers seems particularly dire.

These are big problems. But they are also familiar ones. Most other parts of the world would still love to have California's difficulties. The state is vast, rich (it would be a member of the G7 rich-countries club if it were a separate country), and above all, continuously replenishes its human capital with a stream of talented immigrants. Its array of futuristic industries is second to none.

This leads to the second, more subtle question: one of identity. Joel Kotkin, a Los Angeles writer who was one of the state's few optimists during the last economic downturn, points out that, whereas Texans are all fiercely partisan about their Texanness, Californians argue among themselves, clinging more to their region within the state and to their pet political causes than to the state as a whole. This hurts California on the national stage: its congressional delegation, although the largest in Washington, is often at odds with itself. State politics ends up as a perennial battle between squabbling regions for scarce resources.

In theory, the power crisis could force the state to work together more. There will have to be compromises about power conservation and environmental protection, and the cost will have to be shared. But political cohesion still looks unlikely. The problem is not just Mr Davis (though he notably lacks the charisma of, say, Governor Pat Brown, who oversaw the academic and highway spending of the 1960s). It is also the fact that he and the other politicians in Sacramento control only around a quarter of state spending.

California's political map is a chaotic mess of overlapping cities, counties and school districts. Ballot initiatives have hedged politicians round with spending restrictions and term limits—and given the pols a good excuse to avoid being accountable. Initiatives were partly to blame for messing up electricity deregulation. It is hard to build new roads or schools, and far too difficult to fire bad teachers.

California will bounce back from its current malaise: its industries and its labour force are too strong for it not to. But its political institutions are weak, and getting weaker.

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The Bush administration

Showing this week: the tax cut

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From The Economist print edition

But is it too big?

IT IS perhaps fitting that President George Bush should have chosen to launch his $1.6 trillion, ten-year tax cut in the week that Ronald Reagan celebrated his 90th birthday. Intentionally or not, Mr Bush is exploiting the nostalgia of some Republicans for the heady first days of the Reagan presidency and the supply-side tax cuts that were a central plank of party policy 20 years ago.

In fact, Mr Bush is also drawing a line between himself and the Gipper. He wants to avoid the messy wrangling over tax and spending of 1981 which, Reaganites claim, helped create the run of monster budget deficits that took so long to eradicate.

EPA

And for my next trick...

The new president is proving much more adept than his critics expected at setting the agenda. By focusing on a single issue each week, he has ensured maximum publicity for each one. By the time Mr Bush formally sent his tax plan to Congress on February 8th, tax cuts had been headline news all week. As with his two earlier blitzes (education and faith-based initiatives), the Democrats, who only a few months ago were ridiculing Mr Bush's fiscal irresponsibility, have been falling over themselves to sound open to tax cuts.

In this, Mr Bush has had some invaluable and possibly unexpected help from Alan Greenspan. The Fed chairman's testimony before the Senate Budget Committee on January 25th appeared to give the green light to tax cuts in some form. The result: Mr Bush does not have to argue about the principle of tax cuts, only about the details—how big, what kind, and when. It all seems pretty clear-cut.

In fact, the clarity of the current debate masks some fairly murky fudgings. Chief among these are the government finances. On the face of it, they could not be rosier. The Congressional Budget Office is now predicting that the budget surpluses will be so large in the coming years that the national debt will be paid off in 2006. (The last time this happened was during Andrew Jackson's presidency, in 1835.) This backs Mr Bush's case that planning for long-term structural surpluses (and returning them to taxpayers) should start now.

The catch is that such forecasts are notoriously unreliable. The CBO itself points out that considerable uncertainty surrounds its projections. Above all, the projections assume that spending and tax policies stay the same at a time when every congressman and his dog is proposing some new scheme or other. And Mr Bush now says he favours front-end-loading the ten-year programme of tax cuts: he wants to bring a bigger proportion forward to the plan's early years.

Even if Congress somehow restrains itself, budget forecasters have a poor record of telling the difference between cyclical changes and structural ones. For instance, in the late 1980s Britain's Thatcher government boasted that its surpluses denoted a structural shift in the government's finances; yet the recession of 1990-92 brought record budget deficits. In America, many economists still think that a recession could change the picture dramatically.

The economy is just too hard to gauge. During the election campaign, the gloomiest scenario for 2001 was a significant slowing of the rate of American economic expansion—something many economists regarded as a healthy development. Now the talk is of recession, a word Mr Bush has seized as additional justification for his tax cuts. Indeed, some people think his use of the R-word has heightened the sense of panic.

To help the economy avoid the worst of a downturn, Mr Bush favours making the tax-cuts retroactive to the beginning of this year (thus adding $400 billion to the cost of his plan, according to the Centre on Budget and Policy Priorities). The idea is that by putting money in people's pockets that much quicker, consumer spending will pick up more rapidly (and perhaps first not decline by as much as it might otherwise do) and outright recession, defined as two successive quarters of contraction of GDP, will be avoided.

Here Mr Bush is being naughty. He is making the most of Mr Greenspan's qualified endorsement of tax cuts, while appearing studiously to avoid the Fed chairman's qualification: tax cuts are an ineffective tool of macroeconomic management. In his evidence on Capitol Hill last month, Mr Greenspan recalled that the Ford administration, in which he worked, proposed a tax cut in January 1975. By the time it was implemented in May that year, the slowdown that had prompted the cut was over and the recovery was gathering pace.

That, of course, is exactly the prospect which worries some economists. Despite the fears of recession, most forecasters are betting on yet more interest-rate cuts as Mr Greenspan tries to engineer a soft landing: and most expect that the worst of the downturn will be over some time towards the end of this year. The combination of aggressive monetary easing and a big tax-cut package could put rising inflation back on the agenda. Indeed, some Republicans already imagine, with dread, that the Fed may slam on the economic brakes just ahead of the mid-term congressional elections in 2002.

It is somewhere around this point that the doomsayers begin to run into the same problem as the rosy budget forecasts: they both rely on a lot of "ifs". All that really matters is that Mr Bush remains well aware of all the possibilities, good and bad; and that, unlike Mr Reagan, he keeps control of Congress.

So far the omens on the latter front are good. Mr Bush's formal submission of his tax plan makes clear that he "respects" the constitutional proprieties which require Congress to write tax laws. But just as he has made clear his preferences for retroactivity and front-end-loading, he has also set his face against tax cuts for business (which many Republicans would love to see). It was these tax breaks that Mr Reagan's budget director, David Stockman, blamed for hindering efforts to bring the budget deficit under control in the 1980s.

The Democrats are concentrating their fire on curbing the size of the cuts and redirecting their impact, so that they give less benefit to rich taxpayers. Here, too, Mr Bush has tried to beat them at their own game. At his press briefing, he appeared alongside three average families, all of whom would benefit by an average of $1,600 a year. Asked why there was nobody representing higher-rate taxpayers, Mr Bush replied with a smile that, in fact, there was: "I got a little pay rise coming to Washington from Austin."

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Death and taxes

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WILL he or won't he? Washington has been all aflutter this week over whether George Bush will change his proposal for abolishing the estate and gift taxes. Members of Congress have become a little leery of the original plan because it opens some extra loopholes for the clever and wealthy. It is a little complicated, but, if the president stands fast, you might show this article to your accountant.

Very few Americans, alive or dead, actually pay estate or gift taxes. Each person has a lifetime exemption of $675,000 along with big exclusions for family farms and businesses. On the other hand, those who break this cap lose a whopping 37-55% (in cash) of the assets transferred.

Families already juggle their assets to avoid income tax—for instance, giving shares to children who pay lower rates. Every year you can also give away $10,000 per person, free of gift tax. If all such transfers were totally tax-free, manipulation could reach Italian proportions.

The more complicated fiddle is to do with the capital-gains tax. For assets held more than 12 months, the tax is assessed at 20%. Give an asset to somebody when you are alive, and he or she also inherits the capital-gains bill. Bequeath it, and the "basis"—the price at which the taxman deems the asset to have been bought—changes to the value at the time of death.

The idea behind this "step-up basis" is to let heirs sell assets without incurring both the estate tax and the capital gains tax. Without the estate tax, however, the threat of double taxation vanishes. That would increase the incentive for people not to give appreciated assets away while they are living. It also presents a slightly gruesome opportunity for tax avoidance.

Say you bought a share of Dell Computer for $25 in 1992. Today the share (after stock splits) is worth about $1,600. If you sell it, you will owe tax of $315 (or 20%) on a capital gain of $1,575 ($1,600 minus $25). If you bequeath it to your children and die today, they can sell the share and pay no tax at all. If you are not quite ready to die, but you know someone who is, you now have another option: give the asset to him (he pays no gift tax); have him bequeath it back to you; and collect the asset again when he dies, free of capital-gains tax liability. Your only risk is that Dell's shares dip by more than $315 before he drops.

The notion of ready-to-die clubs offering their services to unfortunate software millionaires eager to realise their earthly gains worries even some hardened accountants. Democrats want to remove the bequest exemption from the capital-gains tax law, and some Republicans want to reduce capital-gains rates anyway. But Mr Bush is sticking to his plan.

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Lexington

George Bush, homme sérieux

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ONLY the other day the clever line on George Bush was that he was nothing but a lazy frat boy. Now, with Mr Bush imposing his agenda on Washington more successfully than any president since Ronald Reagan, the line is that he's nothing but a boring bureaucrat: tidy-minded and business-friendly but utterly devoid of ideas. A cover story in the *New York Times* magazine introduces "the MBA president". The *New Republic* presents him as a 1950s-style "organisation man". The Bush presidency is supposedly a recreation of the Eisenhower administration when, as Adlai Stevenson quipped, the New Dealers gave way to the car dealers.

Mr Bush is certainly immune to his predecessor's obsession with intellectual credentials (indeed, the Clinton White House, all brains, back-stabbing and lechery, was arguably the closest America has ever got to the Sorbonne). Mr Bush's favourite term of endearment is that somebody is a "good man"; his favourite organ is the heart rather than the brain; his least favourite person is Strobe Talbott, a Yale contemporary who spent his time at university burnishing his CV rather than bending his elbow with his fraternity brothers (Mr Clinton loved Mr Talbott). His administration has so far been a model of disciplined efficiency. Every week brings a new White House initiative; every meeting starts and ends on time.

But Mr Bush's Republican Party is a very different creature from Eisenhower's. The past 40 years have seen the creation of a new Republican constituency, the conservative intelligentsia, thanks to the defection of neo-conservatives from the Democratic Party, the rise of right-wing think-tanks and the stalwart work of the op-ed pages of the *Wall Street Journal*. This *rive droite* has played a vital role in driving the Republican Party's successes, persuading it to embrace "unthinkable" ideas such as tax cuts and welfare reform. And Republican presidents who have ignored the intellectual wing of their party—most notably, George Bush senior—have paid dearly.

Mr Bush has been careful to balance practical types like his defence secretary, Donald Rumsfeld, with policy wonks. Condoleezza Rice, his national security adviser, is a former provost of Stanford University. John DiIulio, the head of his newly created office of faith-based and community initiatives, is one of the most impressive social scientists of his generation. Paul Wolfowitz, the dean of the School of Advanced International Studies at Johns Hopkins and a model for a character in Saul Bellow's intellectual-worshipping novel, "Ravelstein", is number two at the Pentagon.

Right-wing think-tanks have an even firmer grip. Mr Bush's labour secretary, Elaine Chao, is the first former fellow of the Heritage Foundation to make it into the cabinet; his chief economic adviser, Larry Lindsey, comes from the American Enterprise Institute; the head of the Office of Management and Budget, Mitch Daniels, is a former president of the Hudson Institute. Even Mr Bush's more practical-minded *consiglieri* have one foot in the think-tank world. Both Dick Cheney and Paul O'Neill have close ties with the AEI, and Mr Cheney's wife is one of the feistiest figures on the intellectual right.

Mr Bush's first three legislative initiatives—on education, faith-based organisations and tax cuts—have all been shaped by policy wonks. His education bill is steeped in the cogitations of the think-tank world, stretching from the leftish Progressive Policy Institute to conservative theoreticians such as Chester Finn. Compassionate conservatism is the brainchild of a small coterie of intellectuals, including Myron Magnet, a spectacularly sideburned scholar at the Manhattan Institute, and Marvin Olasky, a former Marxist turned evangelical Christian. The Bush tax cut owes far more to the ideological conservatism of Ronald

Reagan than to the cautious managerialism of Dwight Eisenhower. And there are more ideas-driven initiatives to come, including the partial privatisation of Social Security, an issue that would still be unthinkable were it not for the relentless agitation of places like the Heritage Foundation and the Cato Institute.

This is not to say that Mr Bush is likely to turn White House meetings into open-ended seminars, like Bill Clinton, or that he is going to waste much midnight oil reading the latest conservative tomes. But he is happy to listen to intellectuals and he understands their role. While he was governor of Texas, Karl Rove, his chief political strategist, made sure that he was plugged into the national policy debate, introducing him to James Q. Wilson and David Horowitz as well as Messrs Magnet and Olasky.

Mr Bush's decision to put Mr DiIulio in charge of his new White House office is doubly significant. It shows that he is willing to put an intellectual in charge of an important issue. (Stephen Goldsmith, the former mayor of Indianapolis, will play second fiddle to the university professor.) But it also shows that Mr Bush has a shrewd sense of how to use intellectuals to advance his agenda.

Critics worry that compassionate conservatism involves subcontracting social welfare to nutty evangelicals. So who better than a high-powered social scientist who also happens to be a Roman Catholic to prove them wrong? Critics also worry that compassionate conservatism is a leap in the dark without any empirical evidence to back it up. So who better than a man who has made his reputation applying quantitative methods to slippery social problems to give the movement some substance? Mr DiIulio is a studiously middle-of-the road figure, an active New Democrat who hangs his hat at the Brookings Institution as well as the Manhattan Institute and who wrote a coruscating article denouncing the Supreme Court decision that brought Mr Bush to office. An intellectual entrepreneur stands a much better chance of getting a new initiative off the ground than a corporate Republican.

Mr Bush's formative experience of Washington was to watch his father's administration disintegrating, in large part for want of "the vision thing". ("Our people don't have agendas," one prominent Bushie said at the time. "They have mortgages.") Mr Bush may not have a vision himself; but he knows the importance of people who do. Forget the sneers from Georgetown: the *rive droite* will provide many of the administration's people and most of its ideas.

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Luxury in New York

What, me worry?

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WHEN Mowgli sniffed the wind for the jungle's news, he knew that to catch the truest scent he had to get as high up as possible. In the concrete jungle of Manhattan's skyscrapers, the same applies: those at the top, the denizens of the penthouses and roof gardens, usually get the first whiffs of a shifting economic climate. And, despite an interest-rate cut and the promise of a big tax cut, a clear whisper seems to be emerging this winter: sell.

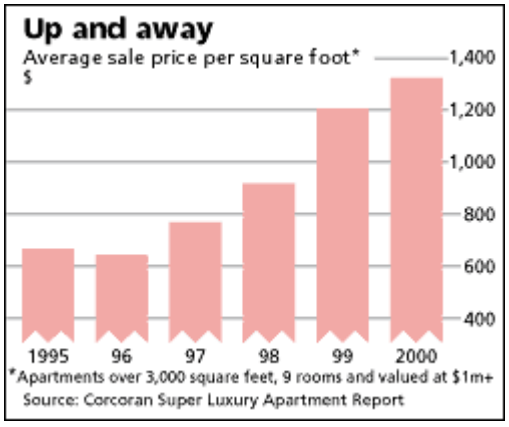
AP

Time for the Donald to duck?

In material terms, most of the city's rich are not much worse off this year than last. The year-end bonuses on Wall Street, paid in December and January, were as generous as they have been in recent years, as the record profits made during the golden first quarter of 2000 compensated for the winter's wobbly finish. But many Wall Streeters worry that they will not be seeing those bonuses again in 12 months' time—and they are adjusting their wallets accordingly.

Last month, the Corcoran Group, a firm that handles luxury apartment sales in the city, found a 35% increase in their inventory over a year ago. The extra listings were heavily biased towards the higher end of the market: rather than risk a drop in prices, wealthy sellers are pocketing their profits.

The feeding frenzy that used to surround the sales of luxury apartments also seems to have abated. "The wild bidding over the asking price is a thing of the past," Barbara Corcoran reports. By "the past" she means three months ago, when an apartment listed at $8m could expect to attract six or eight bidders with competing offers, all above the asking price. Now the bidding on such an apartment would begin at $7m with perhaps two or three bidders at the table. And, when people do buy, they take three weeks, not one, to sign their contracts.



An apartment in Manhattan is a necessity. A second home in the country is an indulgence that people may now be happier to defer. In the Hamptons, where Wall Street keeps its beach hut, there are still adverts in the newspapers inviting people to part with $150,000 for a three-month summer rental. But buyers are suddenly prepared to wait for prices to slide before purchasing. "We are urging sellers to be realistic," says Frank Newbold of Sotheby's International Realty in East Hampton. "The idea that maybe silly money will come along and pay a higher price, that idea is past."

Property is not the only thing causing tremors. Bob Saxon, who has been a consultant for the yachting industry for over 20 years, expects demand for new yachts to take a downturn over the next six months. There are even signs of real pain on the streets. Jill Brooke, the editor-in-chief of *Avenue*, a magazine with a wealthy Manhattan readership, finds that "the whole *zeitgeist* of the culture right now is to be more cautious." The parsimony, of course, is relative: "Instead of three Chanel bags, they may just buy two. Instead of two Ralph Lauren suits, they may just get one."

Lest tears overwhelm you, a silver lining of sorts is at hand. Until recently, Donald Trump *et al* were at the mercy of service industries—tardy contractors who renege on their deadlines and designers who

charge up to $1m to furnish an apartment, but still like to think of themselves as artists. Now revenge is nigh. Ms Brooke hears a “collective sigh of relief” that “some of the prima donna interior decorators and contractors, those drunk with their self-importance, will finally have to consider the meaning of the word ‘service’.”

A decade ago, Manhattan’s wealthy were not just poorer than they are today, but far more frightened of their truly poor neighbours (remember “The Bonfire of the Vanities?”). This year Rudolph Giuliani, the city’s crime-busting mayor, bows out. That, and the possibility of a recession, seem to be making the penthouse-dwellers a little more curious about the welfare of other Manhattanites. According to the Fiscal Policy Institute, the average Wall Streeter earned $216,770 last year, more than four times the income of lesser mortals. A worried Ms Brooke cites Alexis de Tocqueville: “You do need a middle class to protect you from anarchy.” But nothing will save you from interior designers.

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Gun safety

Hands up

Feb 8th 2001
From The Economist print edition

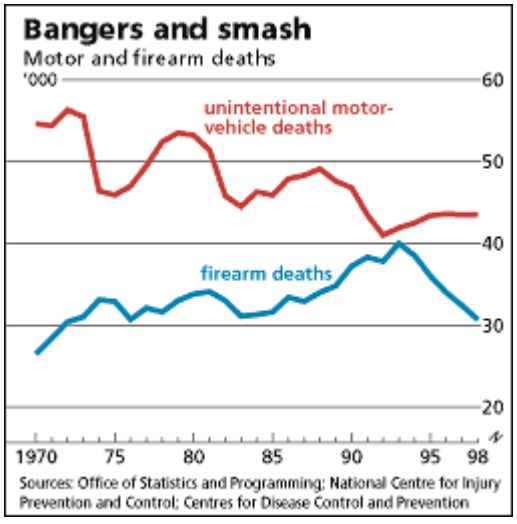
GUNS don't kill people, people do. Yes: but when, where, how and why? Over 30,000 Americans are shot and die every year; yet there is strikingly little uniform information on gun homicides, suicides and accidents, and correspondingly little empirical evidence on how to reduce them.

The Firearm Injury Centre at the Medical College of Wisconsin has created a Firearm Injury Reporting System (FIRS). It is the first in the country. Researchers can now track everything from the calibre of the bullet used in a shooting to the shooter's relationship with the victim. The Wisconsin system should help public-health officials to treat gun deaths as systematically as they deal with, say, cholera and car accidents.

Most of FIRS's work involves collecting data from different agencies: anatomical details about the wounds from the medical examiner, information from the police about the place where the shooting took place, and so on. The system asks questions like those put to aspiring screenwriters (was the crime scene an alley? drug house? bar? convenience store?). The Wisconsin crime laboratory adds data on the gun and the bullet, which it cross-checks with the Bureau of Alcohol, Tobacco and Firearms.

FIRS is modelled on the highly successful Fatality Analysis Reporting System (FARS) set up by the National Highway Traffic Safety Administration in the mid-1970s. FARS requires that up to 100 pieces of information be collected on any motor-vehicle accident in which someone dies, within 30 days. These data, collected in a uniform way from all 50 states, have led to safer cars, better roads, crackdowns on drunk drivers and, recently, confirmation of the deadly connection between Ford Explorers and Firestone tyres.

Since 1970, motor-vehicle deaths have fallen by 20%, while gun fatalities have risen by 16% (see chart). "[Gun] policy decisions have been made with fragmented data at best, and in a vacuum of data at worst," says Stephen Hargarten, the director of the Firearm Injury Centre. Already FIRS is filling that vacuum with useful information.



• A gun-buyback programme in Milwaukee did not attract the kinds of guns most commonly associated with fatal shootings. Five makes of gun were associated with 42% of the fatal shootings in the Milwaukee area, but these five accounted for only 6% of the guns turned in.

• Bill Clinton's much-lauded bill banning assault guns had a limited effect. Guns banned by the 1994 bill were just as likely to be used in a Milwaukee-area homicide (9% of gun deaths) in the three years after the ban as they were in the three years before. "Saturday night specials", small- and medium-calibre guns with a barrel length of four inches or less, are the murder weapon of choice.

• Two-thirds of Wisconsin gun deaths are suicides. Many of the victims are men in their 20s suffering from temporary depression, such as the shock of being served with divorce papers. Many suicides take place within a week of buying the gun; if the person involved can be helped through the trauma, he is likely to live a full and productive life. The United States Air Force used a similar analysis to bring down the suicide rate within the ranks from 16 per 100,000 in 1994 to 5.6 per 100,000 in 1999.

• Guns can be made safer. When the magazine is removed from a semi-automatic weapon, it can leave a

bullet in the firing chamber (whence the common lament: “I didn’t know the gun was loaded”). Many revolvers have a design flaw known about since the 19th century: they can fire inadvertently if the hammer rests against a loaded chamber. Two women were shot in a Planet Hollywood restaurant in 1997 when a pistol fell out of a patron’s pocket and went off.

Understand and deliver

The Wisconsin programme is the most advanced of a number of local data-gathering efforts. Harvard’s Injury Control Research Centre launched a national statistics system in 1999 to support the local programmes and work towards a national reporting system. Officials at the Centres for Disease Control and Prevention (CDC) would like to create an even more ambitious reporting system that would track all violent deaths.

But guns are trickier than contagious diseases. The Ebola virus does not have lobbyists in Washington, DC, notes Dr Hargarten. In 1994, the CDC provided money for seven states to develop data-collection systems. The gun lobby accused the agency of taking sides, and persuaded Congress to cut funding for the project in 1997.

The researchers have their political antennae better tuned this time. They emphasise the goal, common to both sides of the debate, of collecting objective data. One member of the advisory board in Wisconsin is a past president of the Wisconsin Rifle and Pistol Association. And some of the data—for instance, on the assault-weapon ban—would seem to support the gun lobby. Politicians can argue whether guns kill people or people kill people. In either case, it is better to know how and why.

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The Clinton scandals (contd)

Beyond shame

Feb 8th 2001 | WASHINGTON, DC
From The Economist print edition

Reuters

EX-PRESIDENTS are normally treated with exaggerated respect: Gerald Ford and Jimmy Carter were both transformed from the butts of jokes to fonts of wisdom. Yet a recent sketch on “Saturday Night Live” features George Bush trying to make a presidential broadcast, only to be interrupted, every few seconds, by his publicity-obsessed predecessor, offering advice, soliciting gifts and distributing presidential pardons (including one for “the man known as the Gentleman Rapist, a serial sex offender who stalked and fondled hundreds of women in the Little Rock area between 1976 and 1992”).

Bill Clinton fully deserves it. Ever since he left office on January 20th he has repeatedly seized the limelight from his successor, sometimes deliberately, as with his cloying farewell at Andrews Air Force Base, but increasingly less so, with a series of scandals about White House vandalism, financial impropriety and presidential pardons.

It would be hard for Mr Clinton to have had a worse start to his new life, short of pardoning Charles Manson and moving in with Monica Lewinsky. The president’s decision to pardon Marc Rich, a financier who fled the country in 1983 after being accused of one of the largest tax evasions in the country’s history, has shocked even his hard-core supporters. “It was a real betrayal by Bill Clinton of all who had been strongly supportive of him to do something this unjustified,” says Barney Frank, a Democrat congressman from Massachusetts who, in the past, has defended Mr Clinton through thick and thin. “It was contemptuous.”

At the same time, the former first couple’s lust for loot has given the impression of poor breeding, if not outright kleptomania. The Clintons not only decamped from the White House clutching $190,000 worth of gifts (including $7,375 worth of furniture that had been given to them by Mr Rich’s ex-wife, Denise). Mrs Clinton even set up a surreptitious “wedding list” to encourage Clinton supporters to buy furniture for their new houses, taking care to pocket the goodies before she was sworn into office as the junior senator from New York.

Mr Clinton has also come under fire for setting up his publicly funded presidential office in some of Manhattan’s priciest property. He has taken over an entire floor of the Carnegie Hall Tower, with a sweeping view of Central Park, at an annual rent of $800,000—far more than the combined office rents of all his living predecessors.

And the sleaze keeps coming in. On February 5th the *Washington Post* revealed that the “personal” gifts that the Clintons carted off with them included $28,000 worth of furnishings that were given not to the Clintons but to the National Parks Service, to form part of the permanent White House collection. (“I would never give a gift to the Clintons,” said one enraged donor.)

Burnt by the firestorm of criticism and shorn of the protection of the White House press office, the Clintons are hurrying to make amends. They will repay $86,000 of the $190,000 worth of gifts, and return anything that was not meant for them personally. Mr Clinton’s private foundation will also cover some of the cost of his Manhattan office.

Left-leaning Washington journalists are going through a bout of self-flagellation for being too forgiving to Mr Clinton. Richard Cohen, a *Washington Post* columnist, penned a letter to the former president describing Mr Rich’s pardon as “a pie in the face of anyone who ever defended you. You may look bad,

Bill, but we look just plain stupid." An editorial in the same paper concludes that "words like shabby and tawdry come to mind. They don't begin to do it justice."

The immediate winner from all this is Mr Bush. But the Clinton-bashing will not go on forever. It is being pointed out that other presidents, too, including George Bush senior, left office with a lot of gifts (though nothing on this scale). The Clintons are still the most powerful couple in the Democratic Party—a fact that was underlined on February 3rd when their protégé, Terry McAuliffe, was elected chairman of the party. Mrs Clinton is still a champion of the liberal wing of the Democratic Party. And the press is still hardly hostile to the Democratic cause.

Mr Clinton's inauguration as president eight years ago was followed by several weeks of unmitigated disasters. Despite them, he left office as one of the most popular presidents of the century. The comeback kid has life in him yet.

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About sponsorship

Another half-chance for Aristide and Haiti

Feb 8th 2001 | PORT-AU-PRINCE
From The Economist print edition

There can be no doubting that their new president is popular among Haitians. His task now is to satisfy foreign aid donors about his intentions

EPA

IN THE tropical sunlight, the walls of the freshly repainted national palace are so dazzlingly white that it hurts to look at them. Passers-by must avert their eyes from the seat of power as they cross the newly dolled-up park in the centre of Port-au-Prince. All the more glaring is the contrast with the city's huge slums of Cité Soleil and Belair, where the streets remain, as ever, paved with rubbish.

Yet the people of the slums see the redecoration more cheerfully. "It's an example of the government's will to bring about change," says Costaho Blemy of RaRam, a *rara* band of street musicians in Belair. Hopes are high, too, in Cité Soleil. "We have six hours of electricity a day," says Dasmy Louinel, a leader of COMICS, a neighbourhood group linked to the Lavalas Family party of Jean-Bertrand Aristide. "After February 7th, we will have it 24 hours a day."

That is a lot to ask of Mr Aristide, who on February 7th was sworn in as president of Haiti, the poorest country in the Americas (with a GDP per head of $1,379 measured by purchasing-power parity). When, a decade ago, he became the first elected president after the hated dictatorships of the Duvalier family, Mr Aristide promised to raise Haiti's people out of "misery" and into "poverty with dignity". He had little time to do so. A military coup robbed him of three of his five years in office. In 1994, the United States sent 20,000 troops to restore him to power—but on the condition that he did not extend his term to compensate for the time lost.

Instead, he handed over to his chosen successor, René Préval. Mr Aristide, a former Catholic priest and radical leftist, kept control behind the scenes, and lived in a luxurious house in an upper-class neighbourhood (he never explained fully how it was paid for). His election last November came six months after much-delayed local and parliamentary elections, which saw fraud in the vote-counting: ten Senate seats should have gone to a second round, but were awarded straight to Lavalas.

That, on top of months of intimidation and the murder of opposition candidates, prompted foreign donors to suspend the aid on which Haiti's economy depends. The main opposition parties boycotted the presidential election. Officially, turnout was 61%; local journalists say it was under 10% .

Getting the foreign money back is Mr Aristide's first priority. Around $500m (or 14% of GDP) in aid and loans is unspent. Some of it has been held up for years by political deadlock between the opposition and Mr Préval, some suspended since last May's elections. The donors' conditions for restoring aid vary. But all, including the Bush administration in Washington, agree that Haiti must set up a new electoral council that includes opposition members, and hold run-off elections for the disputed Senate seats.

In December, Mr Aristide wrote to Bill Clinton promising that, and more: to co-operate in fighting Haiti's fast-growing drug trade, strengthen the police and judicial system, carry out economic reforms and include opposition members in his government. He continued in this vein in his inaugural speech, promising dialogue with the opposition.

But while Mr Aristide knows he needs international aid, "he will do the minimum necessary to obtain it," predicts a foreign diplomat in Port-au-Prince. It helps Mr Aristide that the letter to Mr Clinton, drafted with (or maybe by) Anthony Lake, the then-president's special envoy, is so vaguely worded as to be almost non-committal.

After several postponements, Mr Aristide met the Convergence for Democracy, a 15-party opposition coalition, but the talks lasted barely two days before collapsing on February 5th. The Convergence said that it would form an alternative government, led by a former presidential candidate, Gérard Gourgue, and invited Mr Aristide to join it.

Social issues, and thugs

That is high farce. No foreign governments will recognise the Convergence alternative. But the donors' demands are pretty farcical too. Even if the election last May had been held properly, Lavalas would have won most or all of the disputed seats. The opposition is fragmented, ranging from former Marxists to ex-Duvalier supporters, and lacks the power to scrutinise aid spending.

The opposition mostly represents the upper-middle class and intellectual elite. By contrast, Lavalas Family is a tightly-run and powerful movement. It has deep roots in Haiti's poorest communities through such groups as COMICS, as well as *rara* bands that sing about political and social issues, and the *chimères*—violent young agitators who seem to be Mr Aristide's budding version of the *Tontons Macoutes*, the Duvaliers' notoriously thuggish enforcers. "We've heard of the opposition," says Mr Louinel in Cité Soleil, "but they've never come down here."

The Convergence is undeterred. "We will build networks and gain the people's support, the same way we did under Duvalier," says Mischa Gaillard, a former ally of Mr Aristide now in the opposition. "But it took time and we had to fight," he adds.

A day before Mr Aristide was sworn in, the UN closed its police-training and human-rights mission. Many donors are disillusioned by Haiti's inability to govern itself with probity or efficiency. To convince them otherwise, Mr Aristide will have to make sure that any money he gets is spent on things like more electricity for Cité Soleil.

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Peru

Videomania

Feb 8th 2001 | LIMA
From The Economist print edition

"HOW much do you need?" That question, posed by Vladimiro Montesinos, Peru's fugitive former intelligence chief, to Agustin Mantilla, a leader of the populist APRA party, and recorded on a secretly-filmed video released this week, has become all too familiar. The answer, in Mr Mantilla's case, was $30,000 for last year's presidential election campaign. Not for the first time, the camera then recorded Mr Montesinos counting out the cash, and handing it over.

Peru is watching an extraordinary reprise of the final years of the regime of Alberto Fujimori, who was ousted in November after a decade as the country's president. So far, a judge investigating Mr Montesinos's empire of bribery and extortion has reviewed fewer than 100 of the 700 videos seized from the spy chief's home (thousands more are said to have been destroyed, or to have vanished). Of these, a handful have been screened on television because they feature congressmen, former ministers or senior judges who can be prosecuted only if Congress first lifts their immunity.

So far, 21 people have been detained on suspicion of corruption. They include four army generals; relatives of Mr Montesinos; and the mayor of a Lima suburb. Another dozen are under house arrest. Some $100m has been found in accounts linked to Mr Montesinos; the total may be $1 billion, congressional investigators say.

Few among Peru's elite have been untouched by the investigations. Dionisio Romero, who is the country's most powerful businessman and is chairman of Banco de Credito, its largest bank, is to be questioned by a prosecutor about a meeting he had with Mr Montesinos to discuss the appointment of receivers for a fishing company. Mr Romero's lawyers deny any wrongdoing by their client.

The videos confirm what many of Mr Fujimori's opponents had alleged: that Mr Montesinos tried to manipulate most aspects of national life, including last year's presidential election. One tape shows the spy chief telling a judge who headed the electoral board how he should conduct the election. The judge was offered (but denies accepting) $10,000 a month and a free eye operation. In another, Mr Montesinos is reported to have handed over $2m to the editor of *Expreso*, a pro-Fujimori newspaper.

In still another video now released, the intelligence chief is shown encouraging a judge to rule in favour of Newmont, a Denver-based mining company, in a dispute with a French rival over a 25% stake in Yanacocha, Latin America's biggest and most profitable gold mine. Mr Montesinos told the judge that the support of the United States for a settlement of Peru's border dispute with Ecuador would be jeopardised by an unfavourable ruling. The judge ruled in favour of Newmont in 1998, but says he did so on the legal merits. American officials deny that they used the border issue as a lever in the Yanacocha dispute, which was settled last year. Newmont says its concern was that the law be followed.

Whether or not there was any wrongdoing in such cases, they show Peru's urgent need for an independent judiciary. Could they help to achieve one? The videos are a "prophylaxis" against future abuses, argues Roberto Dañino, a Washington-based corporate lawyer. "I have dozens of cases where investors have suffered a lack of impartiality from [Peru's] judiciary."

Worried that unseen videos lie like landmines on the path to a presidential election on April 8th, several politicians, including Valentin Paniagua, Peru's caretaker president, have called for all of them to be shown.

Already, the videos have damaged several presidential hopefuls. Mr Mantilla was once the private secretary, and then the interior minister, of Alan Garcia, a former president and now a candidate. Carlos Boloña, Mr Fujimori's economy minister, appears in several, according to a leaked list drawn up by the courts. So does Carlos Ferrero, the running mate of Alejandro Toledo, who heads the polls. Both deny

any wrongdoing.

Jorge Santiestevan, formerly Peru's human-rights ombudsman, dropped out of the presidential race this week. He had failed to gather support. But he was hindered by reports that he is in three videos; his demand that these be screened to prove that there was no corruption involved was ignored.

In response to the politicians' disquiet, on February 2nd the Lima high court arranged for six judges to be installed in a specially-equipped wing of the Palace of Justice. They are to spend the next fortnight viewing the entire library of tapes. And just in case they are tempted to steal any incriminating videos, they will be monitored on closed-circuit television.

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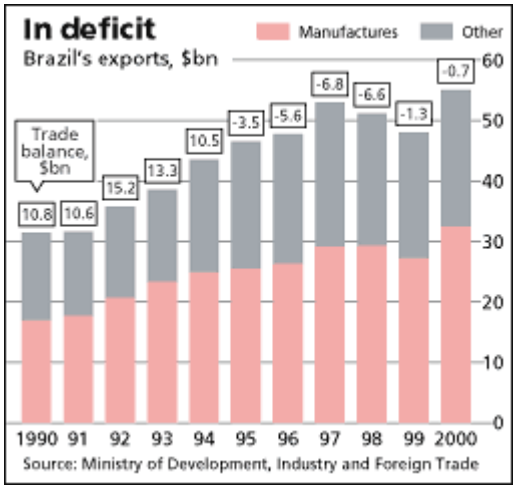
Brazil

Trade beefs

Feb 8th 2001 | SAO PAULO
From The Economist print edition

BRAZIL'S diplomats are an elite within its civil service, and admired as Latin America's best. But should the foreign ministry continue to be in charge of international trade matters? The appointment last month of a new foreign minister—Celso Lafer, a law professor and experienced diplomat—has revived debate over whether Brazil needs an equivalent to the United States' trade representative, a cabinet member with a mandate to strike and enforce trade deals.

One reason for the debate is Brazil's poor export performance. Despite a big devaluation in 1999, Brazil still has a trade deficit (see chart). That is the biggest single threat to the country's quickening economic growth. But there is another reason: Brazil is embroiled in a rising number of trade rows.



On February 2nd, Canada slapped a ban on Brazilian beef, and was quickly followed by the United States and Mexico (its partners in the North American Free-Trade Agreement). That follows long-running rows with Canada over aircraft subsidies and with the United States over drug patents.

Canada's partners had asked it to monitor South America for signs of mad-cow disease, delegating to it the power to impose a NAFTA-wide ban on risky meat. Brazil has had no cases of the disease. Canada says it acted after press reports quoted officials as saying that cattle may have been imported from Europe as late as 1999. Brazil has now provided the information on its animal-health controls that Canada demanded. But lifting the ban could take weeks.

The beef ban came the day after Brazil obstructed Canada's request for a ruling by the World Trade Organisation (WTO) in their five-year dispute over cheap loans that each country offers to customers of their makers of medium-sized jets, Brazil's Embraer and Canada's Bombardier. Unfair retaliation, said Brazil; coincidence, retorted Canada.

Either way, Canada has a stronger case on aircraft. The WTO ruled in 1999 that both countries' loan schemes constituted illegal subsidies. It then found that, while Canada had partly put right its scheme, Brazil had not. So the WTO gave Canada the right to impose punitive tariffs on Brazilian goods (which it has not yet levied). Canada now wants the latest version of Brazil's export-financing scheme ruled illegal. Meanwhile, it has given Bombardier an extra subsidy to help it grab an order worth up to $3 billion from Air Wisconsin.

On drugs patents, Brazil feels vulnerable to being ripped off by multinationals. After Brazil agreed to recognise their patents, in 1996, many foreign drug firms set up manufacturing plants. But the government accuses them of blocking cheaper "generic" drugs (ie, copies of each others' products whose patents have expired), and of profiteering.

To get the makers of two AIDS drugs to cut their prices, Brazil is threatening to invoke a chapter in its patent law that lets it grant local firms the right to make a drug if its patent-holder fails to start making it in Brazil after importing it for three years. Last month, the United States applied for a WTO judgment on this. Brazil has countered by seeking a judgment on a clause in America's patent law which lets it demand that products invented with the help of government aid be made in America.

After years of moaning about barriers to its exports, Brazil is now using the WTO more aggressively to try and remove them. From the creation of the WTO in 1995 until last October, Brazil requested disputes

panels just four times; since October, it has requested another eight. Its export weakness has wider causes. But at least its diplomats are fighting their corner—perhaps from fear of losing it.

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Ecuador battles over cooking gas

Feb 8th 2001 | QUITO
From The Economist print edition

A YEAR ago, protests by Indian farmers against a plan to adopt the dollar helped to topple Ecuador's president. The dollar is now the currency. But this week, the Indians were again on the streets. Their target: a decree which doubled the price of cooking gas, and put up the price of petrol by 22%. This was a tough test of President Gustavo Noboa's commitment to reform the sickly economy.

The farmers blocked roads across the Andean highlands and the Amazon lowlands; in the capital, Quito, thousands camped out in the grounds of a university. Mr Noboa declared a state of emergency; the security forces, trying to clear a roadblock, killed four protesters.

But on February 7th, a deal was struck: the government agreed to freeze the petrol price for a year, and cut that of cooking gas from $2 to $1.60 for a 15 kilo (33lb) cylinder, until it targets subsidies to the poor. The Indians went home.

Four-fifths of Ecuadoreans now live in poverty. For them, cheap cooking gas is vital. But, under dollarisation, the government can no longer print money. Even now, fuel subsidies will cost it 2% of GDP. The increases were needed to balance this year's budget, and were required by the IMF. But the Fund may well swallow the deal, provided the government proceeds with a much-delayed plan to raise VAT.

The Indians have accepted, in principle, an end to universal fuel subsidies. Mr Noboa, Ecuador's sixth president in five years, has been weakened by this battle. But he still has the backing of the armed forces, and of the businessmen of Guayaquil, the main port. And he has survived.

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Venezuela

Party pooped

Feb 8th 2001 | CARACAS
From The Economist print edition

FOR Hugo Chavez, it was supposed to be a long weekend of celebrations. These included the anniversary on February 4th of an attempted coup he led when a paratroop officer in 1992, which led on, seven years (minus two days) later, to his swearing-in as Venezuela's elected president. But now the first cracks are surfacing in Mr Chavez's "revolution": the crowds were smaller than in the past, and the festivities coincided with a messy cabinet reshuffle that revealed more problems than it settled.

The first change was the shifting of Jose Vicente Rangel from the foreign ministry to defence. That was a surprise. Mr Rangel, who is aged 71, had said that his next move would be to resume his career as a crusading journalist. "The president was insistent," Mr Rangel explained, adding, "I place myself in the hands of God".

Well he might. Mr Rangel is the first civilian defence minister in 70 years. He is knowledgeable about the armed forces. But as foreign minister, he was an apologist for the left-wing guerrillas in neighbouring Colombia; earlier, as a journalist, he denounced corruption in the officer corps. Neither is likely to endear him to the high command.

He takes over at an awkward time. His predecessor as defence minister, General Ismael Hurtado, had last month mishandled an incident in which womens' underwear had been sent to the top brass, in an apparent bid to incite them to topple Mr Chavez's government. Whether or not this precipitated his sacking, the minister's departure was unpopular: some 160 generals and admirals held a meeting in his support.

That may have persuaded Mr Chavez to give General Hurtado another job, as infrastructure minister. Two days later, he went further to placate the generals by naming General Luis Enrique Chacon, the deputy defence minister, to a new post of chief of the armed forces. He will handle all operational, training and procurement decisions and will answer directly to the president.

The whole affair suggests that Mr Chavez has less control over the armed forces than was previously thought. Military analysts say that the president made Mr Rangel defence minister only after floating the names of three loyalist generals for the post. These were resisted by their colleagues, partly because their appointment would have required many, more senior, officers to retire.

The reshuffle has also shown the narrowness of the president's band of confidants. He has brought back Luis Miquilena, aged 81, as interior minister; the man he replaces, Luis Alfonso Davila, a retired colonel, becomes foreign minister. Neither seems suited to their new posts. Mr Davila's spell as interior minister coincided with a big increase in violent crime. Mr Miquilena is a wily politician, and presided over a constituent assembly in 1999, but was then accused of corruption (though the Supreme Court, picked by the assembly, absolved him).

Though Mr Chavez is due to remain in office until 2006, he is not as popular as he once was. One poll shows support for the president down to 42%, from 66% two years ago. It is some consolation for Mr Chavez that the opposition remains weak. But with Venezuela's uncertain economic recovery threatened by the falling price of oil, the president's political star now looks to be on the wane.

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Japan starts picking on China

Feb 8th 2001 | TOKYO
From The Economist print edition

Magnum

As its economy shows no sign of recovery, Japan is getting angrier. Some of that anger is being directed against China

LIFE is not always full of thrills for the mushroom bureaucrats of Japan's agriculture ministry. Yet in recent weeks the atmosphere at the ministry's forest-products division has been little short of electric. A flood of cheap imports is threatening Japan's 30,000 *shiitake* growers. An investigation is afoot, involving colleagues from the exalted finance and trade ministries. For the first time since 1955, when Japan joined what is now the World Trade Organisation, talk has turned to invoking its "safeguards"—emergency tariffs or import quotas. Officials are also considering a move against imports of a type of onion, and of the bulrushes used for weaving *tatami* mats. What all three cases have in common is that the targets of Japan's proposed retaliation are Chinese.

It used to be said that the relationship between Japan and China was good if their ageing leaders pronounced it so. These days, a more accurate description is that, despite official assurances, relations are bad and getting worse. For this, the Japanese blame Chinese aggressiveness, in trade and in foreign policy. Yet a good part of the reason can be found in Japan. There, old policies of "engaging" the Middle Kingdom are under sustained attack from an assertive new generation of politicians, academics and journalists. Even foreign-ministry officials have begun to pay attention. Official China policy has suddenly begun to harden.

The China hawks have an attentive audience: as happens the world over, Japan's sick economy and persistent high unemployment are fanning the flames of chauvinism. Racial violence is still infrequent. But milder forms of prejudice are flourishing. Illegal Chinese immigrants infest the building industry, grumble the Japanese, undercutting honest native workers. Chinese crime syndicates are bringing confusion to Japan's carefully-ordered society. Chinese burglars are masterminding a surge in petty crime.

The authorities are taking things seriously. Police statistics on rising crimes by "foreigners" (ie, mainly, Chinese) are followed with keen interest. Until they were hurriedly removed recently, posters put up by the police in Tokyo urged that, since there had been a recent spate of burglaries by "Chinese and other people", "if you notice anyone speaking Chinese, call the police."

Trade friction is also rubbing away at the relationship. Although China has enjoyed a trade surplus with Japan every year since 1988, the Japanese have not worried much until recently. Most Chinese imports, after all, come from Japanese manufacturing plants built in China, underlining Japan's superior role as a supplier of capital and technology to China, in return for access to cheap Chinese labour and natural resources.

But this pattern has begun to change, especially in the ever-sensitive area of agriculture. New refrigeration techniques, better distribution and—in these difficult times—more cost-conscious Japanese shoppers are bringing wheelbarrowfuls of Chinese tomatoes, aubergines, onions and garlic bulbs to Japanese supermarket shelves. Japan's inefficient, and often elderly, farmers cannot compete. On Tokyo's wholesale markets, for instance, Chinese *shiitake* sell for less than a third of the price of Japanese mushrooms, and have quickly snapped up a 40% share of the market.

A threat to its cherished farm lobby is something that even the bickering politicians of the Liberal Democratic Party (LDP), which dominates the coalition government, can unite behind. In the past, the favourite villain for Japan's protectionists was always America, says Yoichi Funabashi, a columnist with the *Asahi* newspaper. Increasingly these days, it is China.

Japanese nationalists of various hues, meanwhile, are starting to call for a more assertive foreign policy towards China. Hawks such as Ichizo Ohara, the leader of the Liberal Party, and Shintaro Ishihara, Tokyo's irrepressible governor, are finding growing favour, especially among younger Japanese. Unburdened by war guilt, younger voters feel frustrated and humiliated by Japan's low international profile and dependence on American soldiers for its defence.

Japan's China diplomacy, thunder politicians such as Mr Ishihara, is weak-kneed. It appeases Chinese territorial assertiveness in the South China seas and across the Taiwan Strait, while allowing generous Japanese aid and soft loans to be met with Chinese insults and demands for apologies for wartime atrocities. These politicians, and their admirers in academia and the media, want a "normal" Japan—a country that can exercise independent diplomacy backed by independent armed forces.

To these Japanese, the disclosure this week of a private e-mail by Lieutenant-General Earl Hailston, the commanding American officer in Okinawa (which hosts 16,500 American troops), says it all. Following an indecent assault in January by an American soldier on a Japanese schoolgirl, the latest in a string of attacks over the years, the Okinawan assembly passed a resolution demanding fewer American troops on the island. Local officials, General Hailston advised his officers, "are all nuts and a bunch of wimps."

Even urbane foreign-ministry types are waking up to the new mood in Japan. Ministry officials have managed to fend off calls by LDP politicians like Shizuka Kamei, the party's powerful policy chief, to slash Japan's overseas aid budget by 30%—cuts that were clearly aimed at China. But after an official review last year, aid to China is nevertheless about to fall.

China's leaders are not deaf to Japanese hostility. During a recent visit to Japan, for instance, Zhu Rongji, its prime minister, refrained from the usual demands for another official apology for Japan's wartime sins, although he could not resist mild needling on the subject. But neither the Chinese nor the Japanese government seems fully abreast of the forces at work in Japan. As Takeshi Sasaki of Tokyo University points out, Japan's economic crusade has largely sublimated its nationalist urges since the war. But, since the crash of the early 1990s, years of recession and financial crisis have upset that delicate accommodation. Japan is getting angrier. And it is unlikely to stop after taking out its frustration on Chinese mushrooms.

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Bathroom blues

Feb 8th 2001 | TOKYO
From The Economist print edition

THE Japanese are far too polite to say it out loud. But every foreigner knows, deep in his heart, that he fails to measure up to Japan's dauntingly high standards of personal hygiene. In short, *gaijin* (foreigners) smell bad. So imagine the disappointment of one poor white man on being denied entry to a public bath on Hokkaido, the most northerly of Japan's four main islands. Foreigners, said the proprietor flatly, were not welcome.

There then followed a period of confusion, as Debito Arudo (né David Aldwinckle) in fact claimed to be Japanese, and had a passport to prove it. After some discussion, the bathhouse owner still refused Mr Arudo entry, on the grounds that Japanese customers would think he was foreign. Fresh from the justice ministry's naturalisation procedures (which include, according to Mr Arudo, an inspection of the contents of one's fridge and the possession of a suitably Japanese house interior), Mr Arudo lost his patience and decided on the unJapanese step of filing suit.

As soon as Mr Arudo's intentions became clear, the bathhouse owner modestly adjusted tack. Foreigners would, after all, be allowed to bathe, but only if they met four conditions: they must have lived in Japan continuously for more than one year; they must sufficiently understand bathing customs; they must understand Japanese; and they must not cause any inconvenience to other customers—that is, they must not stink. Since *gaijin* do, as every Japanese knows, smell bad, Mr Arudo continues his search for justice, and a bath, in the courts.

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Sri Lanka

Order of the boot

Feb 8th 2001 | COLOMBO
From The Economist print edition

ABOUT 40,000 people opposed to the government of President Chandrika Kumaratunga have been marching this week from Kandy, the ancient hill capital of Sri Lanka, to Colombo, its present capital and commercial centre. The *pada yatra* (foot march) started on February 4th, Sri Lanka's independence day, and ended five days and 115km (72 miles) later. The marchers aimed to collect 1m signatures for a petition condemning the government.

EPA

Funeral for the rupee

This demonstration of "people power", an idea that is catching on in Asia and has dislodged two unpopular presidents in the Philippines, was organised by the United National Party (UNP), the main opposition party in parliament. It was supported by trade unions, other opposition politicians and, importantly, by Buddhist prelates, who have great influence in Sri Lanka. They gave their blessing to the marchers as they passed the Temple of the Tooth in Kandy, one of Buddhism's holiest shrines.

Gamini Atukorala, a UNP official, listed the sins of Mrs Kumaratunga's government as the opposition sees them. They include mismanagement of the economy, the condoning of bribery by officials, vote rigging at recent elections and violence against political opponents. Many Sri Lankans also criticise the president for not honouring her promise to end the island's 17-year civil war.

Mrs Kumaratunga ordered her party workers not to disrupt the march. The police were told to protect the marchers if they came under attack. Some shots were fired by men in police uniforms as the marchers entered Kegalle, a town on the route. One person was injured and a van was destroyed. But Mr Atukorala said that demonstrations would continue until Mrs Kumaratunga was ousted. Boot-makers will be pleased, but, if the opposition decides to move politics from parliament to the streets, some worry about the response of the army.

To add to Mrs Kumaratunga's woes, the UNP has asked the Court of Appeal to quash the Central Bank's decision to float the Sri Lanka rupee. The bank exceeded its powers, the party claims. The court has told the bank to answer the charge by February 19th. If it rules against the bank, the economy, already adrift, could be further weakened. At the end of November last year, the bank's foreign reserves, of $978m, were down by 40% from January. The trade deficit had worsened by 43%. The prime lending rate of the commercial banks rose this week to 23%, compared with 14% a year ago.

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Indonesia

Sheriff Wahid talks tough

Feb 8th 2001 | JAKARTA
From The Economist print edition

THE jingle of his spurs drew closer, the porch creaked under his weight, the saloon doors swung open, and...the boys in the black hats laughed and turned back to their drinks. That was the reaction this week to Indonesia's embattled president, Abdurrahman Wahid, who responded to a censure motion from parliament by vowing to get tougher on corruption. Mr Wahid has been making such promises since he took office 15 months ago. But he blames his failures on his coalition partners, who are protecting their rich and powerful backers. Now that they are hell bent on impeaching him anyway, he says, he is free to blast away.

EPA

Tommy on the run

As Mr Wahid was dusting off his Most Wanted list, a pair of court rulings reminded everyone just why that list is so long. On February 5th, the Supreme Court declared former President Suharto, Indonesia's chief plunderer for 32 years, medically unfit to stand trial, upholding an earlier ruling by a lower court. Though the government hopes to fight on, the 79-year-old former ruler may never see the inside of a courtroom.

Mr Wahid had a little more luck with the other court ruling: against one of Mr Suharto's closest cronies, a timber tycoon, Mohamad "Bob" Hasan. This announcement was tainted, however, by what appeared to be a light punishment. Mr Hasan, who was convicted of defrauding the forest ministry through an $87m contract, was fined just $3,000 and handed a two-year sentence. Even this would be encouraging if it were clear that Mr Hasan will actually serve his sentence in a cell: Indonesia's appellate courts are full of surprises, and Jakarta's prisons are notorious for their side exits.

Meanwhile, a hapless posse continues to beat the bushes for Tommy Suharto, the ex-president's youngest son and the only other person whom Mr Wahid has managed to convict for corruption. Last November, after Mr Wahid denied a pardon request, the younger Suharto went into hiding. Ever since, the manhunt has resembled a game of hide-and-seek with a three-year-old: they never look anywhere without announcing it loudly in advance.

Since the police, the prosecutors and the courts are all corrupt, Mr Wahid will find it difficult to improve on this record. Cases against other members of the Suharto family continue to languish; and he has yet to notch up a single conviction in the 1999 Bank Bali scandal, in which funds from the bank-restructuring agency were misdirected into the presidential campaign of Mr Suharto's successor, B.J. Habibie.

Nor has Mr Wahid's government made much progress in bringing the army to book for human-rights offences. A report this week by the International Crisis Group, a Brussels-based think-tank, pointed out that the two successful cases to date have targeted low-level soldiers, rather than their superiors. The many other cases have not even got this far.

Now Mr Wahid is himself under investigation on corruption charges. By issuing a censure last week, parliament warned the president that he must account for his behaviour in a pair of multi-million-dollar financial scandals, or face impeachment in another four months or so. Even if he gives them a good explanation, however, many of Mr Wahid's opponents are already determined to unseat him. And they may prove better than he has at getting their man.

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The Philippines

Estrada dreaming

Feb 8th 2001 | MANILA
From The Economist print edition

WHEN ex-president Joseph Estrada made his first public appearance since being overthrown by last month's quiet revolution, it was to declare he was still the rightful president. The new government insisted that he must be dreaming. But if he is, he shows no sign of waking up. On February 6th Mr Estrada's lawyer asked the Supreme Court to rule that he is, indeed, still president and that his successor, Gloria Macapagal Arroyo, holds office only in an acting capacity.

In his dream, Mr Estrada enjoys a continuing mandate from the masses of poor Filipinos who democratically elected him in the hope of deliverance from poverty. He left the presidential palace only to avoid bloodshed at the hands of the mob of thousands of nasty rich people who were baying at the palace gates, falsely accusing him of lining his pockets with tens of millions of dollars during his 2 1/2 years in office. When Mrs Arroyo—then vice-president and leader of the opposition—took over, it was only to fill his shoes temporarily while he took a break.

The new president, meanwhile, has been having a few nightmares. At one point, she made a nationwide broadcast in which she intoned: "The enemies of the state continue to destabilise our duly-constituted government by machinations and black propaganda." She warned her opponents: "I shall crush you." In reality, Mrs Arroyo is quite secure. There have been rumours that a coup will attempt to restore Mr Estrada to power. However, the armed forces and police appear to accept Mrs Arroyo's leadership. And although the legal basis for her assumption of power is shaky, there is little chance that the Supreme Court will accept that Mr Estrada is still president, and return him to office.

Indeed, Mr Estrada's lawyer says that the ex-president only wishes to vindicate himself. Even if he wins his case, he will take power again only if it is "in the national interest". The real reason for Mr Estrada's assertion of his claim to the presidency is probably to allow his lawyers to argue that, as the legally incumbent president, he enjoys constitutional immunity from prosecution.

A special anti-corruption prosecutor has given Mr Estrada until February 12th to say why he should not be charged with various offences allegedly committed while he was president, including the crime of "economic plunder", which in extreme cases is punishable by death. Mr Estrada's accusers reckon that, while in office, he amassed between 10 billion and 15 billion pesos ($200m and $300m) in secret accounts.

The prosecution of Mr Estrada will be the first real test of Mrs Arroyo's administration, which has had a wobbly start. She has promised a reforming government, but her ministerial appointments have left her open to accusations that she is just repaying political and military hacks who supported her bid for the presidency. A determined effort to put Mr Estrada behind bars will do much to convince sceptics that she means to restore the rule of law.

The Philippines' record in these matters is not promising. It has been 15 years since the last Philippine president accused of corruption, the late Ferdinand Marcos, was deposed, in much the same way as Mr Estrada. Since then, the authorities have failed to prove in court that Mr Marcos committed any crime. And precious little of the fabulous fortune he and Imelda, his wife, allegedly embezzled has been recovered.

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China and India

About a boy

Feb 8th 2001 | BEIJING
From The Economist print edition

IT HAS been 13 months since Ugyen Trinley Dorje gave his Chinese minders the slip, left his monastery in the outskirts of Lhasa, and made a perilous winter-time trek across the Himalayas to join the Dalai Lama's headquarters in exile at Dharamsala, in India. At the time, China's government insisted that the boy, the 17th incarnation of the Tibetan Buddhist Kagyu sect's Karmapa Lama, had not fled China at all, but merely went to fetch some religious relics, and some ceremonial hats, from a monastery in Sikkim. Never mind that he headed off 1,400 km in the opposite direction from Sikkim, complained about Chinese persecution as soon as he got to Dharamsala, and this week accepted refugee status in India—China still refuses to abandon its explanation of his departure.

AP

Lama meets lama

All this stretches credulity and might, on the surface, seem an act of pure self-delusion on China's part. But this response to the Karmapa's flight has been deeply pragmatic, serving China's interests well. For they concern both its rule over Tibet and its prickly relations with India.

China has urged India to handle the Karmapa's case "prudently" and has demanded that he be kept from engaging in any "anti-China activities". At the same time, though, it has carefully refrained from protesting at the decision to grant the boy asylum. That is just as well. India had quietly made clear that it would never consider sending the Karmapa back to China, so a ruckus would only interfere with China's efforts to improve relations with its giant neighbour.

Indeed, the two countries have made remarkable progress on that front, especially given the tensions that erupted in May 1998, when India conducted five nuclear tests and then let it be known that it had done so in part because it considered China its potential "enemy number one". A host of other contentious issues plagues relations between the two, including a tangle of border disputes. China challenges India's sovereignty over several bits of Himalayan real estate, including Sikkim and Arunachal Pradesh: India claims the Aksai Chin, which China holds. The border disputes sparked a short war between India and China in 1962, though last November a minor breakthrough saw an exchange of approved maps in yet another disputed sector.

Another bone of contention is China's role as the most important international patron of India's rival, Pakistan, to which China gives aid, diplomatic support and technical help for its nuclear and missile programmes. Just as that cosy relationship irks India, so China frets over India's hosting of the Dalai Lama and some 100,000 other Tibetan refugees on its territory.

Since "liberating" Tibet in 1950, China has struggled to keep the region's devout and restive population under control. It was during a failed Tibetan uprising in 1959 that the Dalai Lama fled to India. Other serious but smaller episodes of unrest have taken place since, and Tibet remains, even at the quietest of times, alarmingly tense. From his base in India, the Dalai Lama has won support and sympathy from around the world, and managed to keep alive hopes, however faint, of scaling back Chinese rule and restoring a degree of Tibetan autonomy. To China, such hopes amount to rank "splittism", and the Indian government's acquiescence in it is deeply resented.

Yet despite these irritants, the two have been able to do business. A second round of talks on nuclear issues got under way this week. Last month Li Peng, chairman of China's parliament and a former prime minister, made a nine-day visit to India and found some common ground, though India was careful to

show its muscle by test-firing its latest missile while he was there. The two countries share an interest in building a more “multipolar” world order. During the cold war, China saw India as a rival for the role of Asia’s biggest power. Now, more concerned about the threat of overwhelming American pre-eminence, China perceives value in India’s becoming a stronger regional power. China’s interest may also have something to do with its alarm at a growing warmness between India and America, evidenced in President Clinton’s visit to Delhi last year.

China’s pragmatism over the Karmapa issue has extended also to its treatment of the boy himself. Never have the authorities directly criticised him, and never has China shut the door to his possible return. The Karmapa, the foreign ministry’s spokesman, Sun Yuxi, stresses, “is just a boy” and China publicly claims to worry that he might be maliciously used by others with an anti-China agenda. The clear message is that the boy himself is not to blame.

Though his refugee status should make it clear that the Karmapa has no plans to return to his Chinese keepers, it does the government no harm to keep the possibility alive. The boy has reportedly had an unhappy time of it in Dharamsala, where he is under close watch by suspicious Indian security agencies and by his new Tibetan teachers.

Secular and religious leadership have always been intertwined in Tibetan tradition, and reincarnation politics have been known to turn nasty: indeed, there has long been a rival claimant to the Karmapa’s own title. But the 65-year-old Dalai Lama recognises Dorje, making him a strong candidate to inherit at least part of the leadership mantle when the time comes. China might turn out to have been shrewd in not burning a bridge to the Karmapa unnecessarily. After all, it never hurts to have friends in high places.

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Unwelcome to Iberia

Feb 8th 2001 | EL EJIDO AND LISBON
From The Economist print edition

Spain and Portugal used to export workers. Now both countries import them, often illegally. Their experience reflects Europe's confusion over immigration

EPA

GABRIEL BARRANCO runs a business in Almeria province, in deep-south Spain. He needs workers for the plastic hot-houses where he grows vegetables, year round, for northern Europe. Mustafa, an illegal Moroccan immigrant, lives in a shanty town on the edge of El Ejido, centre of the irrigation-based horticultural boom that has made this once semi-desert one of the richest areas in Spain. He wants work. Yet under a new anti-immigration law, Mr Barranco would risk a heavy fine were he to hire Mustafa.

The new law, which has just come into effect, is the unaided work of Spain's centre-right government. It tightens an earlier law put through in 1999 with the agreement of all political parties in the government's first term: the previous rules were too lax, said the interior minister, Jaime Mayor Oreja, arguing that Spain could not assimilate the heavy flow of immigrants that has been coming from Latin America, North and sub-Saharan Africa and Eastern Europe.

He had a point. A year ago El Ejido saw ugly clashes between its native citizens and immigrant workers that had to be quelled by riot police. Racial tensions have spilt out in other places. When foreigners were few, Spaniards prided themselves on not being racist. They're not sure now. Even now, only 1m of Spain's 40m inhabitants are legal immigrants; and over half hail from northern Europe, pensioners many of them, living comfortably on the coast. Asylum-seekers are relatively few. Yet half the Spaniards quizzed by a think-tank admit to being suspicious of foreigners.

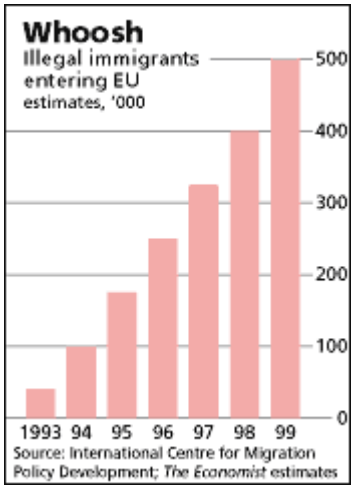
Until the 1970s, Spain exported labour. But as Spaniards became richer and better educated they turned their backs on menial jobs in farming, domestic service and construction. Despite unemployment, still high though much less so than a few years ago, there are some jobs that few but immigrants will now accept. The pay and living conditions are poor, the security little, the risks run on the way to Spain quite large—ten Moroccans were drowned this week when their dinghy sank, just offshore, near Tarifa, at the peninsula's southern tip. But what are meagre wages to a Spaniard are riches to a Moroccan or Ecuadorean and the family he remits them to. So in people flow.

The new law seeks to regulate the numbers coming, to change the attitudes of employers used to relying on illegal workers and to crack down on the crooks who smuggle them in. Most controversially, it also makes provision for the expulsion of illegals, who are reckoned, by some counts, to total as many as 500,000. That requires agreements with their home countries. Spain is beefing up an existing one with Morocco, has just signed one with Ecuador, and is negotiating with Colombia and Poland. These deals would set annual quotas, and make arrangements for would-be immigrants to get Spanish residency papers before setting off. But illegals in Spain hail from 50-odd countries.

The government says it is tightening controls not just on Spain's behalf but Europe's. Spain was getting a reputation, it says, as a place where it was easy to obtain legal status and then move on. And indeed businessmen in places like Almeria complain that they help immigrant workers get papers, only to have them disappear soon after.

The immigrants have reacted to the new law with fear and anger, especially illegals whose applications to be allowed to stay were refused in the past year. The law severely curbs rights granted in the earlier one: illegal immigrants

may no longer strike or organise protests. Still, some have occupied churches, begun hunger strikes and even pleaded directly to King Juan Carlos.



Their countries of origin are getting uneasy. Ecuador is reluctant to take back its 150,000 estimated illegals in Spain; Spain has offered to pay their fares, and take them back in batches of 40,000 a year. But only a few hundred signed up on February 5th, when the lists for voluntary repatriation were opened. Mr Mayor Oreja has assured Morocco that he has no plan to start a "Moor-hunt" redolent of those 500 years ago, after Muslims (and Jews) were kicked out. Why pass the law, argues Spain's Socialist opposition, unless he means to implement it?

Down in El Ejido, Mustafa and his fellow Moroccans have had a late-night visit from local police warning them that their shacks are going to be pulled down; a first step, they fear, to expulsion. In an office at the other end of town, Mr Barranco worries about foreign firms' threats to boycott El Ejido because of the immigrants' plight. He complains that the politicians are out of touch and out of their depth. "We need workers," he insists. "The administration is either ignorant of the real situation or inefficient. Or both."

Babel-on-Tagus

In Portugal the story is much the same. God's successful strategy for halting construction of the Tower of Babel wouldn't work there. With a second Lisbon airport and new stadiums for the Euro 2004 football championship to be built, on many a construction site you can hear Ukrainian, Russian, Romanian and Moldovan, as well as Arabic and a wide variety of African dialects and patois. Communication, in rudimentary Portuguese or English, is difficult, but the work gets done.

Portugal for decades used to export labour: in the 1960s, up to 100,000 Portuguese emigrated each year, and maybe 2.5m, equivalent to a quarter of the domestic population, still live abroad. Their remittances home remain an important source of foreign exchange and family incomes. But now relative prosperity is pulling in migrants from Central and Eastern Europe, as well as the traditional flow of workers from ex-colonies in Africa. At a construction site in the Algarve recently, inspectors found 37 of the 200 workers were illegal immigrants.

Portugal has always viewed itself as racially tolerant and receptive to foreign cultures. Nearly 200,000 foreigners live there legally, about half of them Africans; in 1974, the year before Portugal freed its African colonies, there were only 32,000. Illegals are officially put at 35,000, unofficially at more like 200,000. That would make 400,000 in all, 4% of the population, not much by European standards. And they are needed: with official unemployment down to 3.5%, labour is short. But the new inflows have been enough to strain tolerance and make immigration a big political issue, for the first time.

Many of the newcomers live in appalling conditions in shanty towns close to the bridges or shopping centres that they build. Smuggling rings, thought to have links to East European mafias, ruthlessly exploit those who are illegal. Migration from Cape Verde and Guinea-Bissau has produced virtual ghettoes. The first generation was ready to accept appalling hardships, to escape absolute poverty. They want better for their children. So do the children. Tensions will build up if it doesn't happen. It may not. Bishop Januario Torgal Ferreira recently lamented "the tragic silence of a nation that could not care less about its immigrants." Actually, many Portuguese do care—but in just the opposite way from what he would hope.

What is to be done? In 1992 and 1996, amnesties for illegal immigrants helped to draw in more. Now Portugal has gone the other way: a new law aims to discourage illegal immigration by the issue of temporary work permits, based on the forecast need for labour. Negotiations on official programmes are under way with Ukraine and Romania.

Will it work? No, say immigration specialists: the law rests on an illusion that immigrants will go home when their permits expire. Inhumane anyway, says the left— and the church. Witness Bishop Torgal Ferreira: "Foreigners will be let in for five years to build soccer stadiums, exploited by capitalist sharks and then kicked out." In fact, as elsewhere in the EU, they are likely to stay.

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Farewell, pan-European tax harmony?

Feb 8th 2001 | BRUSSELS
From The Economist print edition

AP

Bolkestein balks

AFTER a common currency for the European Union, why not a common taxation system? Obvious, say keen integrationists. Not to Frits Bolkestein, the EU's Dutch commissioner for the internal market, who this week presented a much heralded paper on tax policy. Some commissioners, not least Pascal Lamy, the Frenchman who runs trade policy, have already signalled their dismay.

The priority, says Mr Bolkestein, is to reduce the tax burden EU-wide. And don't even attempt to harmonise national tax systems across the board. Granted—as Mr Bolkestein did—the EU is already pledged to eliminate "harmful tax competition", but for him a "reasonable degree" of tax competition would not be harmful at all: it would lead to a market-driven convergence towards lower tax rates across the Union.

As the commissioner whose brief includes taxation, Mr Bolkestein has the power at least to shape the debate. But he will not have everything his own way. His proposals are already sparking a "lively debate" among his colleagues; and the commission will not make any formal proposals public until later this year.

But the integrationists will not be silenced meanwhile. Guy Verhofstadt, the Belgian prime minister, has just called for a directly levied EU tax to be imposed on all citizens in the Union. His words carry some weight: Belgium will take over the EU's agenda-setting presidency in July.

Mr Lamy's dissent was more direct. He told a French business newspaper, *La Tribune*, that he queried the Dutchman's whole approach, arguing that it was vital for the EU to mesh national policies: taxation was "at the heart of the problem of co-ordinating political and economic structures". Besides, tax competition could undermine budgetary stability in individual countries. And would it really cause their tax rates to converge? A trifle inconsistently, Mr Lamy doubts that.

Defenders of national control over taxes will be tempted to regard Mr Bolkestein as their flag-bearer. Certainly, by the ardent standards of the European Commission, he ranks as a mild Eurosceptic. Yet even so, some of his ideas may not go down too well in some EU capitals. Though his definition of harmful tax competition does not extend to basic rates of corporation tax, it would still target national tax breaks aimed at bringing in foreign investors. That might go down badly in Ireland, which has used such breaks to good effect, and is already angry at the commission's criticism of its allegedly loose fiscal policies.

Mr Bolkestein also recommends that the commission should make more aggressive use of the powers it already has over taxation. He points out that even if it were to ask for extra formal powers over taxation, it would have to struggle to persuade governments to hand such powers over. So why not use the considerable tools the commission already has, for example over the EU's internal market?

These rules oblige governments not to place obstacles in the way of free movement of goods and people. But differences in national tax systems, for example over the portability and taxability of pensions, could be construed as an impediment to labour mobility.

Mr Bolkestein has such "distortions" in his sights. He even dangles the possibility of drafting a common set of rules for company tax, right across the Union, rather than trying to correct perceived distortions to the single market by getting each of the EU's 15 countries to adjust its own tax system. Mr Bolkestein may not see that as "harmonisation across the board", but it is doubtful that all governments within the EU would agree with him.

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Charlemagne

Goran Persson, a Swede leading Europe

Feb 8th 2001
From The Economist print edition

FROM Goran Persson's office high in the Rosenbad building you look out across the water that laps Stockholm and stretches into the Baltic Sea. Brussels, the administrative capital of the European Union, feels a long way away from the Swedish prime minister's room; the Baltic states, and even Russia, feel quite close by.

The Swedes' distance from the heart of the EU is more than geographical. Their country joined the club only in 1995. It is also one of three members of the Union to have balked, so far, at joining its new single currency; and a large majority of Swedes, according to their pollsters, would like to keep it that way.

For all these reasons Eurocrats in Brussels can be a little haughty about Sweden's six-month presidency of the EU, which allows the Swedes to set its agenda until June. One says this will be "a nice rest" between the turmoil of the French presidency which culminated in the Nice treaty in December and the resumption of serious constitutional debate when Belgium takes over the presidency in the second half of the year. Sweden's priorities—the environment, employment and enlargement—steer deliberately clear of the arguments about political integration that excite people in Brussels.

Yet it would be a big mistake to be dismissive of the Swedes and their prime minister. At home, Mr Persson is sometimes seen as rather aloof and arrogant. But such a judgment says more about the egalitarian Swedish way of thought than about his political skills. To an outsider, Mr Persson comes across as ideally suited to European negotiations: cheerful, shrewd and with a politician's instinctive interest in the sticking-point of the person across the table. More important, whatever people in Brussels think, Mr Persson has got his priorities straight. He is surely right when he says that it is more important for the EU at last to make good on its promise to bring in the countries of Central Europe than to set off on yet another round of agonising about a constitution.

Mr Persson says boldly that, by the time he hosts the EU's summit in Gothenburg in June, he hopes that the Union will be able to offer the candidate countries what they most want—a clear target date for their accession. Cynics in Brussels whisper that the Swedes are kidding themselves if they really think they can make a decisive breakthrough on enlargement during their presidency. But Mr Persson seems to have a clear-eyed view of the difficulties ahead, and what he can do about them. The main nut that he hopes to crack is that of free movement of workers between the new EU countries and the current 15, some of which, notably Germany and Austria, worry about the influx of cheap labour from countries like Poland. Gerhard Schröder, the German chancellor, has called for a seven-year transition period between the new members' accession in, say, 2004 and total free movement.

This is the sort of challenge that the political fixer in Mr Persson clearly relishes. The applicants are realistic, he says: they will give a little. As for the Germans, he indicates, without saying it straight out, that he thinks they too will move. A compromise is in view: there will be a transition period, but probably not one of seven long years. His personal view is that the Central European applicants have more reason to be worried about free movement of labour than the current members. Germany and the others will have no problems handling an influx of Polish bricklayers and bus-drivers. But the new members will struggle if they cannot hang on to their doctors and computer programmers.

Mr Persson's love of a good haggle, honed in years of coming up through Swedish municipal politics, suits him well to the nitty-gritty of accession negotiations. But he is also capable of taking a broader, strategic view of enlargement. He is already thinking seriously about the big issue that will confront the EU if and when enlargement is successfully completed: relations with Russia.

Will Russia feel threatened by a European Union that encompasses almost all of the European continent, but not Russia? And what will the EU do about the fact that, once Poland and Lithuania join, there will be a Russian enclave, Kaliningrad, within its borders? The Swedes, no longer as ardently neutral as they once were (even co-operating with NATO from time to time), are nonetheless keen to engage Russia, by stepping up technical and financial assistance from the EU, with a focus on practical issues like upgrading the sewers of St Petersburg and dealing with nuclear waste, both of which do or may directly affect nearby EU countries.

Of course, the Swedes' focus on enlargement is not simply a function of the breadth of their European vision. Like all other leaders within the EU, Mr Persson must be mindful of the constraints of public opinion at home. He knows that, though polls show that over 30% of Swedes want to pull out of the EU altogether, they also show that his fellow countrymen are the most enthusiastic of any EU citizens about enlargement. Swedes joke that "we want to leave the Union, and we want everybody else to join it."

Mr Persson shows little sign of being inhibited by the trickiness of politics at home. Long hesitant, he now thinks Sweden should accept the single currency, but seems in no rush to propel it that way. Nor does he feel that Sweden's position outside the euro-zone will stop him playing a full role alongside other EU leaders. And, unlike many of them, he appears positively to relish the marathon bargaining sessions that characterise Union summits. At Nice, at three in the morning on the fourth day of negotiations, Gerhard Schröder almost begged to be allowed to go home to Berlin, and Tony Blair emerged vowing that the EU must change its way of doing business. Mr Persson concedes that perhaps the Nice method is not terribly efficient but it has other virtues, he maintains. "There is so much time at these summits," he enthuses, "and the other leaders will really listen to a good argument."

So can his EU counterparts look forward to another marathon when Sweden stages its presidency-ending summit? "Why not?" shrugs Mr Persson, noting that in Gothenburg in June it is just getting light again by three in the morning.

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France

The key to a scandal?

Feb 8th 2001 | PARIS
From The Economist print edition

The extradition of a former top employee of the Elf oil company could embarrass the Socialist old guard more than ever. But it seems unlikely to damage the leading Socialists of today

TALES of high political intrigue, sexual shenanigans and the secret service: France's so-called "Elf affair", in which a state-owned oil company allegedly operated a huge slush fund during the presidency of the late François Mitterrand, has all the elements of a soap-opera.

AP

Don't tell Alfred

Take the arrest last week in the Philippines of Alfred Sirven, a fugitive from French justice for almost four years. As the police burst in on him, Elf's 74-year-old former "director for general affairs" calmly opened the back of his mobile telephone, took out the memory chip, crunched it in his mouth and then literally swallowed its secrets. Bravo Mr Bond!

The question, however, is whether Mr Sirven will at some point disgorge some secrets and, if so, which ones and to what effect. After all, he has boasted that he knows enough to "topple the Republic 20 times over"—an exaggeration, no doubt. But the investigating magistrates believe he has enough knowledge of Elf skulduggery to justify his name appearing 3,649 times in various French and Swiss judicial documents, not counting those which refer to the sale, with Elf's help, of French frigates to Taiwan in 1991 or which point to the involvement in that transaction of Roland Dumas, Mitterrand's foreign minister and close adviser, now on trial in Paris for corruption.

Most immediately interested in Mr Sirven's eloquence or reticence are the six other defendants he now joins, including Mr Dumas. They also number Mr Dumas's former mistress, Christine Deviers-Joncour; Loïk Le Floch-Prigent, Elf's former chief executive, who has already spent time behind bars; and André Tarallo, Elf's "Mr Africa" in the Mitterrand era of the 1980s and early 1990s. All are accused of misusing public funds. Mr Dumas, for example, is said to have placed first Mr Le Floch-Prigent and then Mrs Deviers-Joncour in their jobs, and then to have benefited from the limitless expense account enjoyed by his mistress (whose own description of her lobbying activities was titled "Whore of the Republic").

The interest also goes beyond France, to its neighbour and supposed best friend, Germany. Although Mr Sirven was arrested in Manila on February 2nd, he missed the Air France flight to Paris (the accompanying Filipino policeman did not have a visa), so was put on a Lufthansa flight to Frankfurt. Rather than bundle Mr Sirven on to a waiting French government aircraft, the German authorities stuck to the letter of extradition law. The ensuing delay annoyed the French but allowed a German parliamentary committee to question Mr Sirven about Elf's expensive purchase of a German oil refinery in 1992, with money allegedly funnelled to the re-election campaign of Mitterrand's friend, Germany's then chancellor, Helmut Kohl.

In the event, Mr Sirven politely declined to answer without preparation and so was returned to France on February 6th. There he was interrogated, regardless of age or state of health, in the early hours of the following morning by magistrates who have always seen him as the key with which to unlock the truth behind the Elf scandal.

But assume Mr Sirven spills the beans, will the Republic really be shaken, let alone topple? Perhaps not. One reason is that the cynical excesses of the Mitterrand era, and the moral ambiguities of Mitterrand himself, have already long been explored. When Mr Le Floch-Prigent argues that each dubious Elf transaction had the approval of the Socialist president, the claim has at least a ring of truth. Another is that France's conservatives will hesitate to attack too hard on the Elf affair lest their own dubious past

(for example, illicit party funding when President Jacques Chirac was mayor of Paris) comes under the spotlight.

The best reason for calm, however, is the skill with which Lionel Jospin, the Socialist prime minister (and assumed rival to Mr Chirac in next year's presidential election), has distanced his government from the Mitterrand era and cultivated an image of personal integrity. Indeed, among Mr Jospin's circle, the only politician so far linked to the Elf affair is his former finance minister, Dominique Strauss-Kahn, and then only tangentially in that a former secretary, before Mr Strauss-Kahn was a minister, was paid money by Elf into a Swiss account.

Add to all that the refusal of Mr Jospin's government on grounds of national security to release documents requested by the magistrates. Add, too, the possibility that Mr Sirven will use his secrets to strike a deal. The result will surely be a France that enjoys its political soap-opera, but then shrugs its shoulders. Whether that is a healthy reaction is another matter. When Mr Chirac addressed the nation in December, he described the popular view that politicians are "all corrupt" as a danger to democracy. Indeed. The trial of Messrs Sirven, Dumas and others is unlikely to change that view.

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Russia and Chechnya

No end of war in sight

Feb 8th 2001 | MOSCOW
From The Economist print edition

The Russians are facing a stalemate in Chechnya; they may eventually have to negotiate with the rebels

Get article background

Reuters

IT WAS typical that, within days of President Vladimir Putin's announcement last week that a large portion of Russian troops in Chechnya would start withdrawing, a top general flatly contradicted him. For the Russians are not just hideously bogged down there militarily, with little prospect of an early peaceful settlement; their entire strategy, civil and diplomatic included, is a mess. No sooner has one plan been proclaimed than another seems to take its place. Though Mr Putin last month tapped his old friend Nikolai Patrushev, head of the FSB, as the home-based part of the old KGB is now known, to take overall charge of Chechnya, the administration of the rebel republic is still a muddle. Russian politicians have complained bitterly that, with some nine central ministries and agencies involved, nobody knows who is responsible for what.

Chechnya may be small on the Russian Federation's map. But the scale of the Chechen problem, if only in humanitarian terms, remains immense. Set against other civil conflicts to Russia's west in Europe, such as the ones in Spain's Basque region (where about 800 people have died violently over 30-plus years) or in Northern Ireland (3,000-odd in about the same period), the degree of bloodshed and devastation in Chechnya is many times greater—and looks set to stay that way for the foreseeable future. Russian public support for this second post-Soviet war in Chechnya, though high when Mr Putin launched it in October 1999 when he was prime minister, is declining. If the guerrillas keep going for another few years, the Russians may yet have to face another ignominious settlement on Chechen terms—not unlike the one they signed in 1996.

If you accept the Russians' own figures, more than 15,000 fighters (2,700 of their own men and about 13,000 Chechen guerrillas) have been killed since the second war began 15 months ago, and that does not include the thousands of civilians who have died. Unofficial lobbies, such as the Russian Committee of Soldiers' Mothers, put their boys' body-count at 6,500.

In any event, the killing rate has dropped since the Russians took back the main towns, including the capital, Grozny, last March. But recent reports show clearly that the war is far from over. Since fighting picked up again this winter, when the Russians hoped to take advantage of the harsh conditions for the guerrillas, about 20 of their servicemen have been getting killed every week—picked off by snipers, blown up by home-made mines, hit by rockets fired at vehicles and checkpoints.

Mr Patrushev says there are 5,000 active Chechen fighters (contradicting a figure of 1,500 given by the Kremlin's spokesman a few days before), down from 25,000 at the start of the current war. About 80,000 Russian servicemen (half of them from the regular army) are trying to contain them. The idea, unless the generals stymie it, is to halve that figure, and to fortify some 200 village outposts mainly across the southern half the country.

The latest Russian plan, for which the FSB thinks it is well suited, is to assassinate the three key rebel leaders: Aslan Maskhadov, rebel Chechnya's president; Shamil Basaev, its most fearsome guerrilla; and a Jordanian Islamic zealot known only as Khattab, whose global network provides much cash.

The Russians have three broad aims in Chechnya, and a fourth more distant and fuzzy one. First, they want to give the impression that they are "re-Chechenising" the place—that is to say, putting Chechens back in charge of the civil administration. Second, they want to contain the rebels militarily, since they realise privately that hopes of outright victory in the near future are dim. Third, they want to prevent outsiders from seeing what is really going on, by controlling the flow of news far more tightly than before, so that they can act without restraint against the rebels and the civilians who are suspected of sustaining them. The fourth aim, less openly advocated for the moment, is to dangle the prospect of negotiation through intermediaries, such as liberals in the Russian Duma.

Creating a Chechen administration is proving hard, but attempts to set up civil courts, for instance, are being made. Akhmad Kadyrov, a former mufti of Chechnya who is nominally in charge, is holed up in the Russians' civil headquarters at Gudermes, his life in constant danger when he sallies out; Grozny, under the mayoralty of a convicted embezzler, Bislan Gantamirov, who is building up his own militia (already heavily infiltrated by rebels), is still too much of a wreck to function as a capital. Few towns have electricity; water is delivered, if at all, in lorries. There are no regular flights to Grozny. The real Russian hub in Chechnya is Khankala, a military encampment, replete with airport, housing 20,000-odd troops just east of Grozny.

The population of Chechnya, 1.3m ten years ago, has halved. Of the 400,000 non-Chechens who used to live there, all but 20,000 have gone. Some 300,000 Chechens have fled, many of them west to Ingushetia. According to the Russians, a third of the Chechens who have stayed are homeless.

Nowhere is safe, especially south of the Terek river. Kidnapping continues apace. Since 1999, the Russians say that more than 400 people have been nabbed; nearly 60 foreigners have been victims since the mid-1990s. Ransoms vary from $30,000 to $300,000. In one respect, this suits the Russians: nosey foreigners, from such outfits as Amnesty International and Human Rights Watch, have been forced to stay away. This month, a doughty American doctor from Médecins Sans Frontières was handed back after a three-week ordeal; no one is sure who actually grabbed him. One bold human-rights group still collating information on the spot is Memorial, a Russian organisation based in Moscow.

The Russian government takes journalists on occasional helicopter-borne tours. The only outsiders who consort with the rebels usually get in by bribing Russian officers, including those from the FSB: $1,000 is the going rate. Those recently there say the rebels still move easily through the ruins of all the main towns, Grozny included, and still buy most of their weapons and ammunition from the Russians.

While Mr Putin and his old friends from the KGB act tough, a handful of influential liberals in Moscow, including Boris Nemtsov, leader of the Union of Right Forces, is exploring the possibility of peace—with the tacit backing, they hint, of the Kremlin. Chechnya, Mr Nemtsov says, must remain part of Russia, though he sounds pointedly vague about its final status. But he acknowledges that Mr Maskhadov, not Mr Kadyrov, is still the man with whom a deal must be done—though the rebels' own unity is fragile. In time, President Putin may be forced, reluctantly, to agree.

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About sponsorship

It's a funny old game

Feb 8th 2001
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Manchester United's dominance of football has been matched by its success as a company; but the business side is looking increasingly rocky

THE joint marketing deal with the New York Yankees which Manchester United announced on February 7th says a lot about what the club has achieved. A decade ago it was a struggling team in a lacklustre business. Now it is the partner of choice for America's biggest baseball team in a promotional and licensing deal.

PA

Ferguson knows Beckham's price is rising

Good management has turned Manchester United into the richest football club in the world by a considerable margin. A study by Deloitte & Touche, an accountancy firm, covering the 1998-99 season ranked United first in terms of turnover (see the chart below). In terms of profitability, the gap was wider. In that year, United's pre-tax profit was a healthy £22.4m. Real Madrid, with a debt of more than £100m ($145m), would probably be broke if it wasn't a football club.

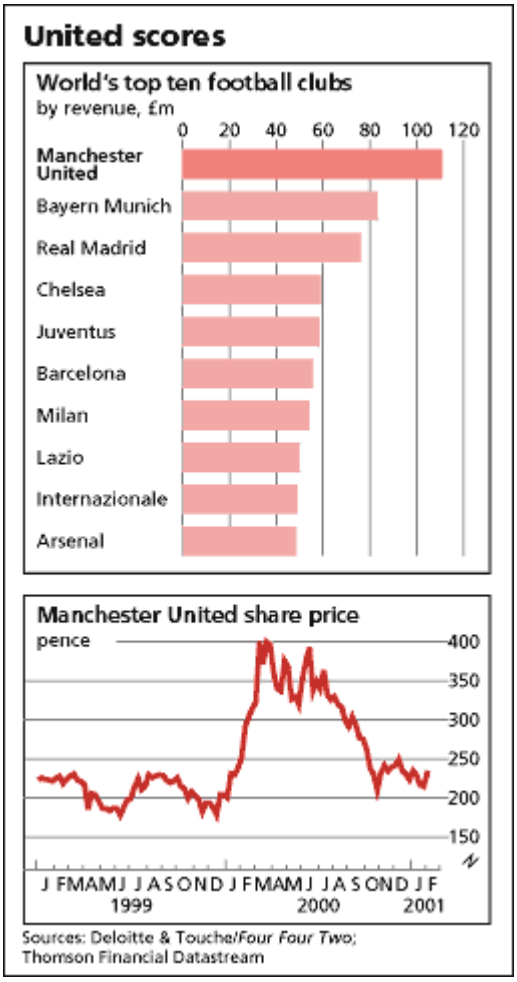
Underpinning United's finances is the world's largest fan base. A survey published this year by UFA Sports, a Hamburg-based sports rights distributor, found that 26% of European football fans thought that Manchester United was the best club in the world—two-and-a-half times as many as those who chose Barcelona. United has almost 14m fans across Europe, more than any other club. In Britain, it also has nearly two-and-a-half times the number of supporters that Chelsea, the Premier League team with the next-largest fan base, has.

Thanks to worldwide satellite coverage of the Premier League, United also has an astonishing level of support outside Europe, especially in Asia, where there are Manchester United shops in Singapore, Bangkok, Kuala Lumpur and Hong Kong. So geographically disparate is the club's fan base that when last year the team visited the other Manchester club, Manchester City, newly promoted from a lower division, City fans held up a banner which read "Welcome to Manchester".

And this success is a relatively new phenomenon. It started in the early 1990s, when the Premier League, which United has won six times in eight years, was founded. Before that, there were 20 years of relative failure during which Leeds, Arsenal and, above all, Liverpool were ascendant. Even then, however, United had a lot of support—partly because of the sympathy generated by the Munich air disaster in 1958 which killed eight of the club's players, and also because of the glamour of the Best, Charlton and Law era in the 1960s. "It was", says Mark Oliver of Oliver and Ohlbaum, a media and sports consultancy, "a brand waiting to be rediscovered."

By a combination of luck and good management, United started winning games just as satellite television started up, and Rupert Murdoch's BSkyB began spending big money on football. Sponsorship was also taking off at the time; and, thanks to Edward Freedman, the club's marketing genius, branded products became a big business.

Today, merchandising and sponsorship bring in 26% of the club's revenues. Both look likely to grow even faster in the future. Nike will take over worldwide merchandising next year, splitting the revenues with the club and promoting the brand, in particular, in both Asia and North America. The deal will earn United at least £300m. This season, Vodafone entered into a four-year shirt sponsorship agreement worth over £30m.



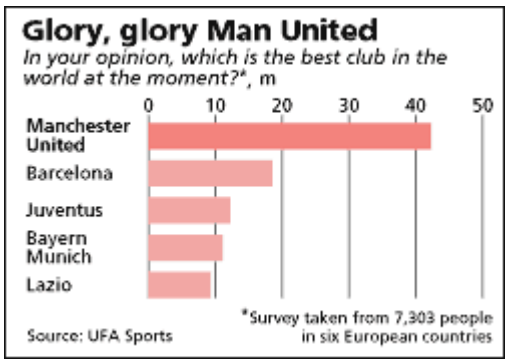
Television income is also about to leap again, thanks to the Premier League's £1.3 billion deal signed last year by BSkyB and ITV, and which takes effect at the beginning of next season. Half of the money will be distributed on the basis of the number of television appearances and league position—so United will get the lion's share, and can expect to earn over £25m a year. Television money from the UEFA Champions League in Europe also keeps on increasing. Last year, despite going out in the quarter finals to Real Madrid, United made nearly twice the operating profit—£16.9m—it made when it won the competition the previous year. United now has its own television channel, MUTV, a joint venture with Granada and Sky, which will soon be able to show Premier League games two days after they have been played, and is developing grand plans for using the Internet to distribute its content.

Even the abolition of the transfer system, which has been forced on reluctant clubs by the European Union, seems likely to work in United's favour. To the frustration of its manager, Sir Alex Ferguson, the club has refused to pay the £30m-40m transfer fees that clubs demand for top players, such as Rivaldo, Zinedine Zidane and Luis Figo. Thanks to the EU's action, transfer fees seem likely to disappear, and the competition to spend will shift to wages. As a solid business with fat revenue streams, United should fare better in that sort of competition. Nor does United have any reason to fear a little-noticed decision by UEFA, the European game's ruling body, which has set other clubs trembling. It plans to introduce a licensing system for clubs next year, which will make solvency and transparent accounts a condition of playing in major tournaments.

But things are not quite as rosy as all that. United's share price has almost halved since the end of last season and last year's pre-tax profits were 25% lower than the previous year's at £16.8m, although television income increased by £8m. That was partly because United played five fewer home games, but the main culprit was what the outgoing chairman of Tottenham Hotspur, Alan Sugar, bitterly calls the "prune-juice effect"—as fast as money goes in, it comes out the other side in the form of players' wages.

Thanks to its excellent youth scheme, which allows United to sign up good players early, the club has enjoyed the services of stars such as David Beckham and Ryan Giggs at well below their market value. No longer. Five important players' contracts, including those of Mr Beckham and Mr Giggs, are up for renegotiation. Nobody will be surprised if they get at least £100,000 a week—twice the wages of Roy Keane, currently the club's best-paid player.

There is no obvious solution to the prune-juice problem. Oliver Butler, editor of *Soccer Investor*, a newsletter, suggests that to align the interests of players more closely with shareholders, they should increasingly be paid partly in share options. It's a nice idea, but one that's unlikely to get the attention of players.



While costs continue to rise, it looks as though revenues may level off. Income from television, which will soon overtake match ticket sales, may be getting near its peak. Previous deals with BSkyB have probably worked to the broadcaster's advantage because they have done so much to boost satellite-dish sales. The new deal, however, is largely defensive—BSkyB could not allow any other broadcaster to take football away from it—and could actually damage subscription growth because of the amount of money that BSkyB will have to claw back from its customers.

UEFA may also have trouble screwing more money from television for the Champions League. The addition in 1999-2000 of a second stage and six more matches for each club still involved has been criticised for dragging out the competition. There are signs that the audience's interest may be flagging because of too many "meaningless" matches.

As for pay-per-view (PPV), the toe-in-the-water experiment that begins in Britain next season with just 40 matches is designed to stop the biggest clubs from running off with all the money. In time, it seems likely that Manchester United, Chelsea, Liverpool, and other teams with country-wide support, will be allowed to negotiate their own PPV deals, as already happens in Italy. But that may cannibalise future subscription revenues, thus redistributing money from clubs with small fan bases to the already rich and reducing competition in the Premier League to the point that even the supporters of the top clubs start turning off. BSkyB's viewing figures for football this season are rumoured to be slightly down on last year, despite increased subscriber penetration, perhaps because most people decided the title race was over by Christmas.

This all assumes that success on the pitch for United is inevitable. But at the end of next season, Sir Alex retires after 17 years as manager. The last time United tried to replace a long-serving, dominant and hugely successful manager—Sir Matt Busby—it went into such a tail-spin that it was relegated to the old second division in 1974. There's not a chance of that happening again, but orderly successions are difficult. Gary Neville, one of the players to have come through the youth scheme to become a first team regular, recently pointed out that players who have known Sir Alex since they were little more than children will not feel the same bond with a new manager.

Peter Kenyon, the newish chief executive, is a competent professional, but choosing a replacement for Sir Alex will be by far the most difficult thing he has done. If he gets it wrong, Manchester United could be in for some relatively lean years. Were that to happen, income would grow more slowly, and the temptation for the club to try to spend its way out of trouble by signing expensive new players would be strong.

After the best part of a decade of exceptional success, Manchester United is the nearest thing there is in football to a business. With more sponsorship and television money flooding in this year and next, the immediate future looks bright enough. But businesses which can't control their costs are inherently fragile. And football may still be more of a religion than a business. That is bad news for the United empire, and possibly the devotees in Kuala Lumpur. But it is cheering for fans of other English clubs, for whom a decade of United dominance has been purgatory.

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About sponsorship

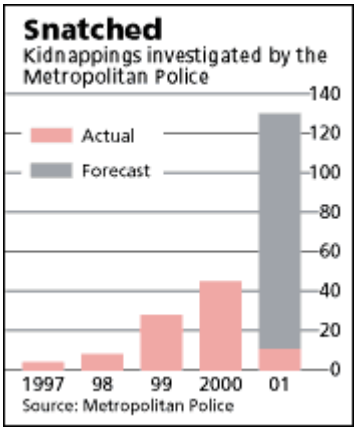
Kidnapping

Open season

Feb 8th 2001
From The Economist print edition

THE sorts of people generally assumed to be susceptible to kidnapping are aristocratic heiresses and the relatives of football stars; or unlucky business types snatched to jungle hideouts by foreign guerrillas. But in Britain, the business of kidnapping is less glamorous and more democratic. It is also booming: in London, where the crime is concentrated, the number of kidnappings investigated by the police has risen 16-fold in three years (see chart). Last month, London's Metropolitan Police dealt with 11 cases of kidnapping, more than it encountered in the whole of 1998.

Two sorts of victims largely account for this explosion. One is the illegal immigrant, smuggled into Britain and then held by the traffickers until his family pays a ransom, or his freedom is earned through slave labour. The victims come mainly from Fujian province in eastern China. Their families save up to pay so-called "Snakehead" gangs for a passage to countries in the West, but upon arrival in Britain the immigrants are incarcerated, and often tortured. Sometimes they are seized in batches by other Chinese trafficking gangs, eager to discredit their rivals.



The other main species of victims are themselves criminals (in police parlance, the offences are "bad on bad"). Along with guns, kidnappings have become a popular weapon among London's criminal gangs. They are motivated either by vengeance, or the collection of unpaid drug debts, which evolve into ransom demands.

According to Detective Chief Superintendent John Coles, who oversees the Met's newly formed anti-kidnap unit, there is the realistic possibility of murder in two-thirds of kidnap cases. Sometimes killing is the main motivation, but the kidnappers consider that they might as well turn a profit before doing the deed. A broad spectrum of London's ethnic communities is involved; one Russian gang recently kidnapped the same person twice. Both sorts of kidnap, Mr Coles says, can involve extreme violence, which relatives are sometimes obliged to overhear on the phone.

Compared with the old-fashioned variety, inter-criminal kidnappings are not especially lucrative: the ransom demand can be as little as £500 ($740). But they do have one distinct advantage for the perpetrators, which they share with the kidnapping of immigrants: the victims and their relatives think twice before contacting the police. The families of Chinese victims are reluctant to approach the Chinese authorities, and freed illegal immigrants are wary of deportation. The associates of snatched London criminals prefer not to attract the attention of the law, and indeed some victims have been prosecuted themselves after being liberated. Mr Coles says that some afflicted families take a day or two to weigh up the pros and cons of calling in the Met.

These sorts of anxieties make it difficult to secure kidnap convictions, and help to explain why, according to the National Criminal Intelligence Service, kidnapping has historically been under-reported. Greater confidence in the police may partly account for the rising statistics. But kidnapping does seem to have become more common. The Met is reluctant to encourage the fad by talking about it; but on the other hand, prospective kidnappers ought to know that the force retrieves all the hostages it is informed about, alive, with no ransom paid. Treated as murders waiting to happen, kidnaps are a top police priority, and are usually solved within two days.

Of course, globalisation has created a boom in kidnapping in other parts of the world. Perilous destinations for travellers include Columbia, Mexico, and parts of Africa and the Far East. Crash courses in how not to get kidnapped, and insurance to cover the ransoms, have for some years been bought by companies that send employees to these hot-spots. Gerald Moor, of Inkerman, a British firm that

supplies such services, says they are now also being sought by anxious parents, whose children are embarking on pre-university adventures. But on the streets of London, such well-heeled youths are much less likely to be kidnapped than are illegal immigrants or the denizens of the capital's underworld.

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High society meets the reptiles

Feb 8th 2001
From The Economist print edition

WHAT a swelegant, elegant party! The Press Complaints Commission's glittering bash this week to celebrate its tenth anniversary was the nearest London gets to high society. In a gathering too close to parody for comfort, the PCC succeeded in bringing together Prince William, the heir to the throne, his father, Prince Charles, the royal mistress, Camilla Parker-Bowles, as well as pop stars, super-models, cabinet ministers, senior civil servants and other wannabes.

Reuters

Charles and William, supping with the enemy

The one thing this disparate bunch had in common was that most of them had sought the protection of the PCC over the past decade. Their principal tormentors, the editors of the nation's tabloid newspapers, were there in force to greet their victims, so it was not surprising that a certain frisson swirled around the party.

That so many prominent glitterati turned up to devour the PCC's canapes and rub shoulders with the royals is, no doubt, a triumph for its chairman, Lord Wakeham. He can fairly claim to have restored confidence in self-regulation and saved the press from privacy legislation. A skilled political fixer, he has used his chairmanship to pressure the press barons such as Rupert Murdoch into corralling their editors.

The PCC's code of conduct, drawn up by a panel of editors, is generally observed. Press standards have improved and complaints have fallen by nearly a third over the past five years. The industry, which not so long ago was said to be "drinking in the last-chance saloon", with self-regulation in terminal disrepute, is grateful.

The party was meant to celebrate this success. The soap stars and the models, judging by the amount of drink going down their throats, certainly enjoyed themselves, as did the editors. But whether Prince Charles and Prince William were wise to associate themselves with this lot is doubtful. "Never sup with the enemy" is a good motto. At least the royals could tell who to avoid because all the guests had name tabs.

Lord Wakeham, who helped get rid of Lady Thatcher without her even knowing, is a skilled operator. But this lavish party has given an opening to those critics who claim he is too close to the industry and too protective of the powerful. "We're here to protect the vulnerable" was the slogan of a big banner that greeted the guests. That was not the main impression the evening made on the minds of those who staggered out of the grandeur of Somerset House, high on champagne and celebrity. The truly vulnerable were nowhere to be seen.

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About sponsorship

Bagehot

Irrepressibly Gordon

Feb 8th 2001
From The Economist print edition

WHO now remembers Tony Blair's first cabinet reshuffle, in the summer of 1998? But for the promotion into the cabinet of Peter Mandelson, and the ousting of Harriet Harman and Frank Field from the Department of Social Security, it was a lacklustre affair. Its one striking feature was the construction that political commentators were authorised to put upon it: that the prime minister had intended to clip the spreading ambitions of Gordon Brown, by sacking or sidelining half a dozen of the chancellor's protégés, and promoting his own in their stead.

Three years on, Mr Brown's stock stands higher than ever. The chancellor is adjudicator of the five economic tests which, the government says, will determine when Britain joins the European single currency. He is poised to deliver an election-winning budget of tax cuts and hand-outs. Following the resignation of Mr Mandelson, he will now command this election campaign alone. And all the while, he has been making the party's intellectual weather. Nobody talks these days about Mr Blair's "third way". But at 11 Downing Street, Mr Brown thinks big thoughts with visitors ranging from Britain's chief rabbi to James Q. Wilson, the American apostle of moral revival.

Mr Brown's return to eminence has fascinated *aficionados* of Whitehall's turf wars. In such conflicts, the cabinet reshuffle is the equivalent of the blitzkrieg; prime ministers can change the balance of forces at a stroke. Chancellors fight back by attrition, a mode of warfare in which they enjoy a singular advantage known as Her Majesty's Treasury. Not even Mr Blair, an allegedly "presidential" prime minister who has stuffed 10 Downing Street with record numbers of staff, has anything resembling a prime minister's department capable of matching the resources available to his neighbour at Number 11.

So complete has the chancellor's victory been that it has begun to worry Parliament. The House of Commons Treasury select committee complained last week that Mr Brown's Treasury is exerting too much influence over policy areas which are properly the business of other departments. The MPs acknowledge that the Treasury is guardian of the public purse and must ensure that taxpayers' money is spent efficiently. But they do not think this justifies the influence the Treasury now wields over the strategic direction of the government. Under Mr Brown, they say, the Treasury gives the impression of having taken over policymaking on welfare reform from the Department of Social Security, and on microeconomic policy from the Department of Trade and Industry.

One way in which the Treasury has done so is by means of the public-service agreements (PSAs) which spending departments are nowadays required to negotiate with the Treasury as part of the government's regular spending reviews. This innovation has a noble aim. In the past, governments have tended to measure how well they are doing in any particular policy area by counting the amount of money they are spending on it. It would plainly be better to measure the output of government spending than the input. The PSAs therefore set out performance targets for each department (the Home Office, for example is under orders to reduce domestic burglary by 25% by 2005), which are monitored by the Treasury and taken into account when it is doling out money.

Inside the government, a lively argument is going on about whether a surfeit of numerical targets can have perverse effects on policy. Did a pledge to shorten hospital waiting lists encourage hospitals to give priority to minor cases? The chancellor accepts that he might have pushed targeting a bit far: the

number of PSA targets for the period 2001-04 has been pruned to about 160 from the 600 set out in 1998. But there can be no arguing with the fact that, even if for the best of reasons, the PSAs have greatly extended Mr Brown's reach.

Does this matter? Here the debate splits. A high-minded, quasi-constitutional debate has to do with good government. The Commons select committee thinks it wrong for the Treasury to set the PSA targets as well as acting as sole judge of whether they have been met. MPs would therefore like the targets to be monitored by an independent body accountable to Parliament. A lower sort of debate turns on whether Mr Brown is once again too big for his boots.

The danger here is that people whose real objection is to Mr Brown will find a high-minded quasi-constitutional pretext to object to his growing power. Stuart Weir, director of Democratic Audit, a constitution-watching think-tank, argued in last week's *New Statesman* that Britain already has an over-mighty political executive and that the Treasury's "near-monopoly" on policymaking reduces the checks and balances that other departments once provided. But, like some of Mr Brown's fellow ministers, Mr Weir plainly objects not only to the way Mr Brown's policies are made, but also to the (rightward, even though Mr Brown is often labelled lazily as "Old" Labour) tilt of the policies themselves, especially the adoption of tax credits instead of universal benefits and stakeholder pensions instead of the previous Labour government's income-related pension scheme.

These are honest enough differences. But it seems odd to criticise Mr Brown on quasi-constitutional grounds. It is true that Mr Brown has detailed views on an unusually broad range of policies. This no doubt vexes less forceful rivals in the cabinet. But even the select committee concedes that the strategic direction of the government is ultimately a matter for the prime minister; and the weight Mr Blair assigns to his various departments depends largely on how he sees the respective political weights of his ministers. Since his first blitzkrieg, Mr Blair has learnt just what a heavyweight his chancellor is. It would be folly for the prime minister to pick another fight.

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Northern Ireland

Broken windows

Feb 8th 2001 | BELFAST
From The Economist print edition

TWO years ago some troops were withdrawn because peace seemed to be coming to Northern Ireland. Last year, they were deployed once more to quell feuding between loyalist paramilitaries; last week they were back again to protect Catholics against Loyalist attack. It was for the same reason that troops were first sent onto the streets in 1969 when the “Troubles” began.

Reuters

Small-scale, but scary

There have been scores of attacks on Catholics this year, mostly amateurish but terrifying. Shots have been fired and crude but potentially deadly pipe-bombs have been thrown through windows. The attacks usually happen in darkness; some start fires.

Nobody has died, yet, but many have had close shaves. In North Belfast, for instance, a bomb was thrown through a living-room window, starting a fire. A wife and children were sleeping upstairs at the time; had the husband not been downstairs, they might have died. A few miles away, a pipe-bomb was thrown into the car of a Catholic worker in a community centre. She held it for a moment before throwing it out.

The number of attacks seems to be rising. On February 5th, police noted five attacks in five different places, all by loyalists. Two were apparently connected with an old loyalist feud, the other targets Catholic.

Why is this happening now? Sectarian violence goes in waves. An upsurge last year was concentrated in Larne, a predominantly Protestant port in County Antrim. According to Danny O’Connor, the local representative of the moderate nationalist SDLP, the aim was to drive Catholics out of Larne. He accused police of not taking the problem seriously and blamed the largest loyalist paramilitary force, the UDA, which has supposedly been observing a ceasefire since 1994. Along with other nationalists, he also wondered out loud why unionist politicians have been comparatively quiet on the matter, when they have been so vocal in demanding that the IRA give up its weaponry in return for the presence of its political wing, Sinn Fein, in government.

An internal loyalist feud which played itself out in Belfast late last year seemed to soak up paramilitary energy for several months. The loyalists managed to bury their differences, and stopped killing each other. Shortly afterwards, around the beginning of this year, sectarian attacks started in a string of towns: Larne, Ballymena and Bushmills in County Antrim, Coleraine in County Londonderry and Londonderry itself. Now the attacks have spread to volatile North Belfast. Most targets have been Catholic families in largely Protestant districts. Some churches and businesses have also been attacked.

Unionists have always explained Protestant violence as a reaction to the IRA. But now these attacks are happening when the IRA is maintaining a ceasefire. David Ervine, a member of the struggling new legislative assembly and a political spokesman for the UVF—which last year caused most deaths in the feud with the UDA—claimed recently that other loyalists are simply lashing out at Catholic targets because they see nationalists and republicans as the political winners in the peace process.

Sir Ronnie Flanagan, the Royal Ulster Constabulary’s chief constable, remains unwilling to blame the UDA as an organisation for the attacks. He suggests instead that individuals with UDA links are responsible. Indeed, some people suspect that a centralised UDA no longer exists. There is talk of bitter disagreement among the paramilitaries’ political spokesmen over crime rackets run by prominent figures as well as support for a ceasefire. The picture is one of leaderless localised gangs.

The big worry is that these attacks will inevitably cause a death or serious injury sooner or later, and that will lead to republican retaliation, risking a spiral of violence against the backdrop of stalled politics. And the best hope is that the primitive nature of the attacks suggest a fading impulse, not a sharpening one.

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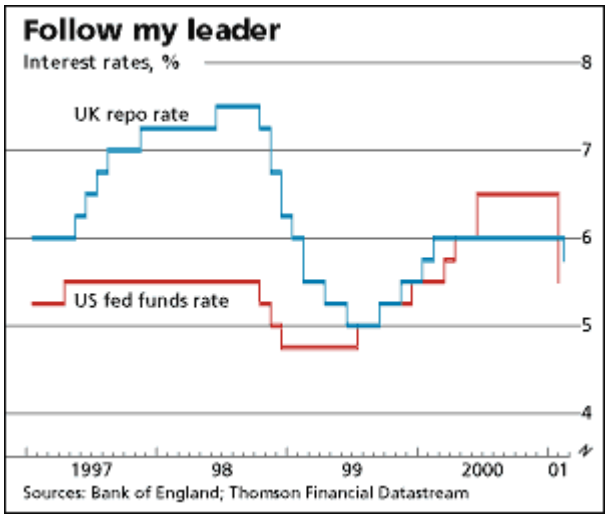
Down they come

Feb 8th 2001
From The Economist print edition

THE Bank of England may have kept the markets waiting in January, but this week it delivered the cut in interest rates they were expecting. After a year in which the base rate has been held at 6.0%—the longest period of inactivity since the Bank was made independent in 1997—it was lowered to 5.75%.

The rationale for the Monetary Policy Committee's decision was foreshadowed in the minutes of the January meeting, when four members of the nine-strong MPC, including Charles Bean, the Bank's new chief economist, voted in favour of rate cuts. The most dovish of these dissidents argued then that inflation had been below the 2.5% target for the best part of two years and that "recent developments were likely to push it further below".



That particular forecast proved correct, since inflation subsequently fell from 2.2% to 2.0%. Indeed, the National Institute of Economic and Social Research recently forecast that it will fall further, to below 1.5%, by the end of the year.

The Bank is bound by its remit to worry as much about under-shooting the inflation target as over-shooting it. If inflation does fall below 1.5%, Sir Edward George, the Bank's governor, will have to write a letter to the chancellor, explaining why this lapse has occurred and how the MPC intends returning inflation back to its target level. Rather than face this embarrassment, the MPC probably concluded that it would be simpler to cut interest rates now.

However, the clinching argument is likely to have been further evidence that the American economy is weakening rapidly. This has prompted the US Federal Reserve to cut rates aggressively since the start of the year.

Before it became clear how sharply America's economy was slowing, the hawks on the MPC used to worry that consumer demand would remain too strong to make room for the public-spending boom, and that this would stoke inflation. But America's slowdown now seems bound to reduce growth in Britain, partly through reduced demand for exports, partly through lower inward investment by American firms and partly through slower growth in the City, as the world's financial markets become less buoyant.

The Bank's move can be interpreted as a precautionary step to ensure that the economy does not suffer unduly from the American slowdown. It is now likely to sit on its hands for at least three months. The Bank may now be politically independent, but it will be reluctant to move rates near to an election.

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Art market

Portrait of the artist as a brand

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Like most successful consumer businesses, Damien Hirst's empire is based on a strong brand and an efficient manufacturing operation

AT AUCTION, Damien Hirst's pictures do not fetch the prices that the modern masters command. One of his paintings of rows of different coloured spots, up for auction at Sotheby's in London on February 7th, went for £220,000, while Lucian Freud's "Large Interior W11"—the most expensive painting by a living British artist—fetched £3.3m in 1998. But as a businessman, Mr Hirst, the driving force behind the BritArt movement, is unsurpassed.

"Becoming a brand name is an important part of life," says Mr Hirst. "It's the world we live in." The happy conjunction of a strong brand with a wide variety of products, many of them low-cost, leaves him with enviable margins.

Mr Hirst, the 35-year-old son of a second-hand car dealer from Leeds, understood early on that publicity was the way to build his brand. In 1988, at the age of 22, he mounted Freeze, a show of his and fellow second-year students' work at Goldsmith's College in London, courting collectors and press alike.

A master of the spectacle, he ensures that he is rarely out of the public eye, and is the only contemporary British artist to receive the same recognition and riches as footballers and rock stars. Solid blocks of traffic surrounded the opening of his show at the Gagosian Gallery in New York last September where collectors paid a total of $11m for the 31 pieces on display, including Hymn—a 20ft high painted bronze anatomical model, purchased before the show by his patron, Charles Saatchi, for $1.5m.

Mr Hirst's entrepreneurialism would have been unacceptable in a British artist only a generation ago. To market your own work—let alone seek to become multi-millionaire—would have been deemed vulgar. But then Britain is a brasher sort of place these days. Michael Craig-Martin, an American-born artist and a tutor at Goldsmith's, argues, "English society is as aggressive, outspoken and vulgar as it was in the 18th century, and Damien is a part of that."

The prices Mr Hirst commands, and the volumes in which he sells, are testament to the power of his brand. Experts reckon that prices for some of his best-known work have increased 100-fold in a decade. Jay Jopling, Mr Hirst's London dealer, has sold almost 300 butterfly and spin paintings alone. Collectors have snapped up 400-500 spot paintings, which Mr Jopling now sells for up to £200,000, according to size. A miniature 20cm by 20cm spot painting is now for sale at his gallery, White Cube, for about £20,000. For those with smaller budgets, signed photographic prints of a spot painting entitled Valium are being sold for $2,500 in an edition of 500 from Eyestorm.com. "I find the pieces sad, or happy or even dumb. I think I'll always make them," Mr Hirst has said.

Meanwhile, his first book, "I want to Spend The Rest Of My Life Everywhere, With Everyone, One To One, Always, Forever, Now", published three years ago, has sold 27,000 copies at £75 each. A signed copy is £300. Demand for anything by Damien Hirst is so high that even copies of the invitation to the Gagosian show (a pillbox designed by Mr Hirst containing details of the exhibition) have been sold on the eBay Internet auction site.

Mr Hirst does not actually make anything much any more. Gone are the days when he sloshed around in a tank injecting a (dead) tiger shark with formaldehyde to create "The Physical Impossibility of Death in the Mind of Someone Living", the work that made him a star. The only piece at the Gagosian show in New York to which Mr Hirst put a hand was an unfinished painting in a glass case called "Concentrating on Self Portrait as a Pharmacist".

Like Andy Warhol in the 1960s, Mr Hirst now has a small factory which converts his ideas into reality. Mr Hirst employs ten full-time artists in two south-east London studios, with a third in Gloucestershire. His brother, Bradley, has also been pressed into service.

Bradley spent months working on “The Void”—a cabinet containing 5,000 pills handmade from lead, tin, pewter and plastic on display in New York. Three more are in the pipeline, along with Mr Saatchi’s latest acquisition: a water-filled glass cabinet containing a gynaecological table and 30-odd fish swimming around. Frank Dunphy—a former theatrical accountant whom Mr Hirst met in a pub—acts as the artist’s business manager, running the show from an office in Bloomsbury called Science.

Mr Hirst’s venture into the London restaurant business has meanwhile proved less successful. Pharmacy, a Notting Hill restaurant—whose concept and décor (dangling skeletons, glass-fronted medicine cabinets and chemist’s jars filled with brightly coloured liquid) are by Mr Hirst and whose profits he shares—lost £1.5m in the first half of 2000. But Mr Hirst will no doubt soon find more profitable avenues for brand-extension.

Mr Hirst’s critics suggest that the gap between his works of art and mere business transactions is too narrow—that some of his images (including the ubiquitous spot paintings) have been recycled to the point of meaninglessness. Mr Hirst argues that they miss the point. “The hand of the artist isn’t important,” he maintains. “You’re trying to communicate an idea.” How fortunate for Mr Hirst that his artistic convictions and his business interests coincide so neatly.

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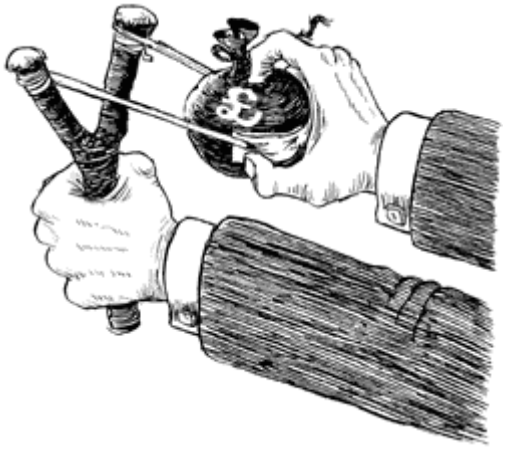
Tax cuts

Bombe surprise

Feb 8th 2001
From The Economist print edition

Blanket tax cuts are out of favour. For this election, the parties are targeting particular groups of people



AN ELECTION campaign without a war of words on tax would be a challenge to the imagination of British politicians. This week, they duly failed it. Labour trashed a new Tory policy to cut taxes on savings. The Tories counter-trashed Labour's big idea for cutting taxes for most families with children. True to form, the Liberal Democrats trashed both policies.

That much was predictable. What was unexpected was the trashing-ground. For two decades, tax rows have centred on income tax. Now both parties have abandoned this familiar, if toxic, battlefield for an exciting new one where they lob "targeted" tax cuts at deserving groups while pounding the other side. Gordon Brown, the chancellor of the exchequer, got in first with the idea, but William Hague, the Conservative leader, was quick to follow, ruling out "indiscriminate" tax reductions in favour of cuts "to help those who need and deserve it most". Suddenly the air was thick with precision-guided devices showering bounty on favoured social and electoral groups.

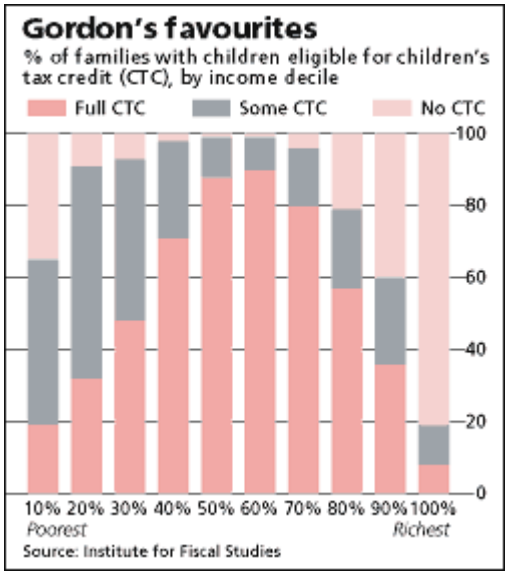
On offer from Labour this week was the children's tax credit (CTC), as the chancellor launched a publicity campaign for what he described as "our family tax cut". The target group is around 5m families with children. Announced as long ago as the 1999 budget, the CTC will conveniently put money into their pockets this April, a month before the expected date for the election. Most families entitled to receive it will get at least £8.50 a week, and Mr Brown has said he hopes to increase this to £10 in the March budget.

Costing around £2 billion, the CTC is artfully designed to appeal to moderately well-off families with children (see chart). Labour has already funnelled a lot of money to poor families. Now it is seeking to complement this with help for middle-income families while ensuring that the money does not go to high earners. The poorest families will not gain, because they do not pay income tax and will therefore not receive the credit. But neither will families that include a high earner, since the CTC will be phased out once one of the parents earns enough to pay higher-rate income tax (£33,935 next tax-year). The withdrawal rate will mean that families where one earner has an income above around £41,500 will gain nothing.

While Labour has been seeking to shore up its support among younger women who are bringing up children, the Tories are targeting the 50-plus vote. The Conservatives announced an ambitious plan to reform the taxation of savings that will use up £3 billion of the £8 billion they have earmarked for tax cuts by 2003. At a cost of £2.3 billion, they will abolish taxation of interest for most savers with banks and building societies. A further £700m will pay to get rid of taxation on gross dividends for many shareholders.

The Tory proposal for savings reform is clearly very different from Labour's children's tax credit, but the two tax pledges have this in common: they do not invite higher-rate income taxpayers to the

party. Under the Conservative proposals, they will continue to pay existing rates of tax on both interest and dividend income. Their exclusion was crucial since very wealthy individuals would otherwise have benefited disproportionately. The Conservatives estimate that as many as 18m individuals may benefit. However, the big gainers are likely to be better-off older people.



The trashing began at once. Both the Conservatives and the Liberal Democrats pointed out that the CTC, unlike the universal child benefit, requires means-testing and that a million families who have failed to apply for the credit may therefore miss out. Labour countered by rubbishing the Tories' savings proposal, saying that it would principally benefit better-off savers. The Lib Dems warned that it could weaken incentives for people to save for pensions.

Through the fog of battle, some surprising points of common ground between the two main parties can be glimpsed. The shared strategy of targeted tax cuts reflects the fact that the Tories have essentially endorsed Labour's decision to make higher public spending the priority over the next three years. That has left them scraping the barrel of spending cuts to muster £8 billion of tax reductions by 2003—not enough to make sweeping cuts in income-tax rates.

There is also more common ground on the need to help saving than meets the eye. Labour has itself sought to relieve the taxation of savings by introducing cash ISAS (Individual Savings Accounts) which allow savers to shelter up to £3,000 of cash from tax on interest every year. The Conservatives' proposal essentially removes this limit and extends the tax privilege to all lower-rate and basic-rate income-tax payers who receive interest on their deposits. Much the same could be said about the Tories' plan for dividend taxation, which will similarly extend the current tax advantage of ISAS used to invest in stocks and shares.

Despite these similarities in both their overall strategies and specific policies, the parties will seek to exaggerate the differences. The Conservatives believe they can make gains among disillusioned older voters. They will unveil further measures to secure the votes of traditionally-minded electors who want to see more support for marriage and the one-earner family. Labour, fearful of low turn-out, will target its "heartland" voters with more help for pensioners. Expect more "targeted" sorties, loaded with electoral bounty, before May.

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Sharon's famous victory, Barak's crushing defeat

Feb 8th 2001 | JERUSALEM
From The Economist print edition

EPA

Ariel Sharon, Israel's new right-wing leader, did so well in the election that he may not be able to form the national-unity government he wants

Get article background

HIS victory over Ehud Barak in Israel's election on February 6th was so huge that it could prove self-defeating for Ariel Sharon. The 25% margin of defeat prompted Mr Barak to announce his resignation as party leader, leaving the prime minister-elect with no one in authority to talk to about setting up the Likud-Labour unity government that he dearly desires.

Mr Sharon had hoped to offer Mr Barak the ministry of defence in a partnership that would give him the basis for a comfortable parliamentary majority. If he cannot bring Labour in, he will have to weld together a volatile amalgam of all the rightist, religious and Russian factions in the Knesset. He must do so, moreover, before the end of March. Otherwise there will have to be general elections, for the Knesset and for a new prime minister too, later this year.

If there are such elections, Binyamin Netanyahu, a former Likud prime minister who is now, say opinion polls, once again superbly popular, will be there, ready to make his comeback bid. It was the prospect of continued parliamentary mayhem in the present, gridlocked Knesset that persuaded him to pull out of the election just held.

Labour may install its elder statesman, Shimon Peres, as temporary leader while the younger contenders for the party leadership gird up for battle. Mr Peres, a spry 77, could even be a contender himself. He favours the national-unity option, but it is unclear whether he could impose his position on his traumatised and dejected party. Doves, such as Shlomo Ben-Ami, the out-going foreign minister, and Yossi Beilin, the minister of justice, are arguing forcefully against accepting Mr Sharon's invitation. They say that a unity government will, in effect, mean paralysis on the peace front. Meanwhile, Labour, by serving in it, will have compromised itself, and further fragmented the already splintered peace camp.

Mr Sharon's victory was expected. But no one predicted quite such a clobbering for Mr Barak, who himself defeated Mr Netanyahu just 21 months ago by 56-44%. At that time, the turnout was close to 80%; this time it was less than 60%, the lowest in Israel's history. In absolute numbers, 1.6m people voted for Mr Sharon—200,000 fewer than the number who voted for Mr Barak in 1999. Some 967,000 voted for Mr Barak. More than 70,000 of those who went to the polling stations cast blank ballots.

A significant part of the drop in turnout is attributable to a mass boycott of the election by Arab-Israelis (see article). Arab politicians said that their anti-voting campaign, which alone rendered Mr Barak's chances of winning almost nil, persuaded many Jewish voters to stay away too.

The no-shows and the blank balloteers together reflected a pervasive disillusionment in the peace camp with Mr Barak personally. He was portrayed, often by his own ministers, as aloof and domineering, and his handling of the negotiations with the Palestinians was criticised as inept and insensitive. The day after

the election, punch-drunk peaceniks were still citing opinion polls to show that a majority of Israelis continue to support the “peace process”. But it would be wishful thinking to let such arithmetic obscure the fundamental fact, however unpalatable, that the Israeli public has lurched rightwards under the impact of the Palestinian *intifada*, and in the wake of Mr Barak’s ultimately unsuccessful attempt to negotiate a comprehensive end to the conflict.

While people still tell pollsters that they vaguely favour peace—recognising this, Mr Sharon’s slick election campaign portrayed him as a peacemaker—there is no longer a clear majority for the Oslo accords, which are the only peace process actually in play. The chief cause of the swing to the right seems to have been the middle-of-the-roaders’ incensed reaction to the Palestinians’ rejection of Mr Barak’s peace proposals.

Israelis felt that the Barak government had made the most generous possible offer (too generous, said the right), including the re-partition of Jerusalem, only to have it spurned by Palestinian negotiators. Meanwhile, the bombings and ambushes continue. “Israelis above all hate feeling that they’ve been made patsies of,” wrote a columnist in one newspaper, *Ma’ariv*, to explain Mr Barak’s colossal fall from favour.

A concession speech, with additions

Among those bracing themselves for a closer result was apparently Mr Barak himself. He prepared a fighting concession speech, which meticulously catalogued the achievements of his brief administration, and consoled his party faithful with the assurance that his peace policy had been “ahead of its time” but would ultimately be embraced by both sides as the only practical parameter for a final, permanent settlement. “We have lost the battle, but we shall win the war,” the former army commander declared as the downcast throng of Labour volunteers made a brave effort to cheer.

But he then went on to stun his listeners by saying he would quit politics “for a period” once the new government had taken over. The announcement seemed a hastily added addendum to the original address. “Don’t leave,” the youngsters cried. Others were less distraught. “It was a brave and responsible decision,” said the Knesset speaker, Avraham Burg, himself a would-be successor. “Honourable and inevitable,” according to the interior minister, Chaim Ramon, another leadership hopeful.

Mr Sharon himself said nothing at all about Mr Barak in his victory speech. “Israel is starting out on a new course,” he proclaimed. But where, precisely, will this course take a confused country?

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The Arab world

Fear of Sharon

Feb 8th 2001 | DAMASCUS
From The Economist print edition

Get article background

ARABS have greeted Ariel Sharon's election victory with a mixture of fear, revulsion and dismay. "Israel Votes For War", was the morning-after headline in one Beirut daily. "The triumph of this bloody terrorist, war-criminal and butcher is a straightforward declaration of war," echoed the organ of Syria's Baath Party. Yet, beyond the outrage, cooler heads were predicting little more than a postponement of the regional peace that many see as inevitable.

It is no secret that Arabs dislike the Israelis, but if there is one single Israeli who inspires violent feelings it is the prime minister-elect. Jordanians recall the time in 1953 when a force led by Mr Sharon destroyed the village of Qibya, leaving 69 civilians dead. Egyptians remember that it was Mr Sharon who flouted a ceasefire during the 1973 war, counter-attacking across the Suez Canal to turn Egypt's initial success into near-defeat. Syrians, Lebanese and Palestinians all know him as the mastermind of Israel's 1982 invasion of Lebanon, an act that led to the loss of 40,000 Arab lives and to Israel's 18-year occupation of southern Lebanon.

To some, Mr Sharon's election only confirms what they have been saying all along: that the peace overtures of his predecessors were a sham, and that in their hearts Israelis have no real intention of granting Arab rights. "Who cares. Barak and Sharon are two sides of one coin," is a sentiment heard from Palestinian refugee camps in Syria to the literary salons of Cairo.

A senior Egyptian official, however, takes a more sanguine view. However good Mr Barak's intentions may have been, he notes, the fallen prime minister was too weak to produce results in peace negotiations. Mr Sharon may be no angel, but he will still have to be dealt with. Previous Israeli prime ministers thought "unsavoury", such as Messrs Begin, Shamir and Netanyahu, did, after all, keep the peace ball rolling. The Palestinians' leader, Yasser Arafat—who was personally targeted by Israeli bombs during Mr Sharon's siege of Beirut—says that he will pursue talks with whatever government Mr Sharon forms.

Still, even Arab countries that have agreements with Israel are expecting tense times. Never has the balance of military power in the region been more in Israel's favour. Not surprisingly, foreboding about a newly aggressive Jewish state has prompted moves to consolidate Arab ranks, fractured since the Iraqi invasion of Kuwait in 1990.

There is little doubt that Mr Sharon's victory will speed the rehabilitation of Iraq, a country that has traditionally been seen as the Arabs' strategic hinterland. Egypt and Syria have both just signed free-trade agreements with the Baghdad regime. Jordan is soon to follow. The deals are low on substance, given the UN's control of trade with Iraq, but high in symbolic value, particularly in the case of Syria, a country that has long had only the iciest of ties with Iraq.

A summit of Arab leaders is scheduled for next month. Judging from the current flurry of regional diplomacy, the idea will be to challenge Mr Sharon's Israel with a convincingly united front. The message will be particularly strong if, as expected, Saddam Hussein himself attends the meeting for the first time in a decade.

These moves are also meant to send a message to the new American administration which, some Arabs fear, intends to carry out the campaign talk of escalating the punishment of Iraq, and perhaps renewing the "unfinished" war. Writing in *Al Hayat*, Elias Hanna, a Lebanese military analyst, takes a less gloomy view of America's potential role. He argues that, if Mr Sharon goes too far, America will be obliged to take things in hand, in order to prevent chaos.

Small consolation, perhaps, but the alternative, as most Arabs see it, is for the Palestinian *intifada* to continue indefinitely, until its tragic toll at last convinces Israelis that Mr Sharon's promises were hollow. "The Israelis want to have their cake and eat it," says Lebanon's prime minister, Rafiq Hariri. "They want peace and security, and they want to occupy our land. It's impossible."

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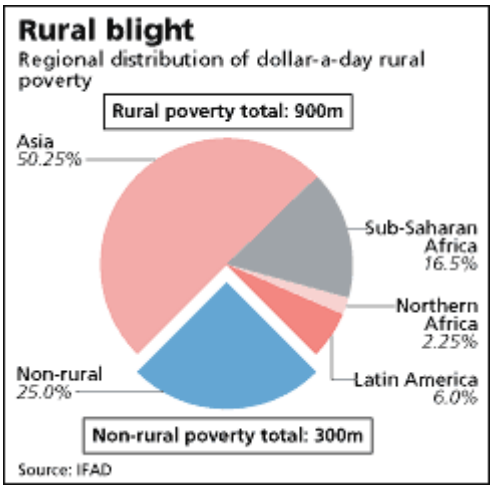
Helping the dirt-poor

Feb 8th 2001 | ROME
From The Economist print edition

BOLD aims are easy enough: getting things done is the hard bit. The United Nations' millennium summit last year resolved to halve the number of the world's poor by 2015. Five years earlier, UN members had agreed to work out programmes to end the worst sorts of poverty. Yet the rate of poverty reduction in the past decade was less than a third of what is needed to achieve the UN's goal, says a report published on February 6th by the International Fund for Agricultural Development (IFAD), a Rome-based agency that tries to help the poorest of the poor.

About 1.2 billion people live in extreme poverty, meaning on less than a dollar a day. Three-quarters of them live and work in rural areas. So, says IFAD, it is necessary to concentrate on the countryside, and on what can be done to make poor farmers more efficient.



Sticking its neck out, IFAD wants to see an expansion of the use of genetic technology in farming, which it reckons will increase crop yields and reduce disease among animals and plants. It also argues that a redistribution of land into more equal holdings, especially small family farms, will help efficiency. Less controversially, it calls for an improvement in the distribution of water to the rural poor, and for better roads so that they can get their products to the market more easily. And, of course, it says it is essential to have more education and better health-care.

The agency is particularly keen on improving the lot of rural women. They are generally poorer than the men, it says, less educated and in worse health, own no land and die sooner. "There is an enormous case for investing in women," says Eve Crowley, who advises IFAD on the subject. To put it crudely, women are an under-used resource. And the fact that in many places they have no access to credit hampers rural development.

In Burkina Faso, for instance, it has been found that they farm land more productively than men. In general, better-educated women will bring up healthier children, who can then get more out of the soil. And when women do earn money, they tend to spend it more cannily—on the kids and the household—than their menfolk, whose first thought is often a transistor radio or something of the sort.

That one of the five candidates in the election for IFAD's new president on February 20th is a woman from Nepal is a small step towards equality among those who preach it. This is the first time a woman has competed for the top job. If she were to win, it would set an example in the huge stretches of the world where sexual equality—and the greater efficiency it can bring—is still an idea that most men have barely begun to grasp.

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Kenya

Moi, the juggler

Feb 8th 2001 | NAIROBI
From The Economist print edition

HE HAS run Kenya for 23 years. Does President Daniel arap Moi really mean to stand down next year, as the constitutional amendment of 1991 says he must? “Succession is like a wide river that should be crossed carefully. You might need a boat or ship,” he told a baffled crowd this week. “And that is why I say we should have a peaceful transition.” The leaders of an opposition pressure group were meanwhile being arrested and beaten up by the police, with whom they had been seeking to register a forthcoming rally.

Rallies can be risky entertainment

The group concerned, Muungano wa Mageuzi (movement for change), has made the mistake of pressing Mr Moi to bow out in 2002, when an election is due. It is also part of Ufungamano, a coalition of interest groups, led by Kenya’s clergy, which is campaigning for constitutional reform. When Mageuzi was founded last year, the president seemed not to consider it much of a threat. He merely told the police to avoid the movement’s rallies, for their own safety, he said. But, soon afterwards, the rallies were banned by presidential decree, and attempts to defy the ban were broken up with baton-charges. Mr Moi now says Mageuzi is a revolutionary body in the pay of foreign powers dedicated to overthrowing his government.

Given that Ufungamano is in the mainstream of Kenya’s reform movement, that seems unlikely. Last year, the ruling alliance, between the Kenyan African National Union (KANU) and the National Democratic Party, pushed through an amendment to the Constitution of Kenya Review Act, which had the effect of commandeering the commission that the act had established. Ufungamano was formed when the interest groups that were thereby shunted off the commission decided to carry on regardless.

Ufungamano claims that Mr Moi has hijacked the process of constitutional reform, which in Kenya would mean paring the president’s almost unlimited powers. The group also challenges the constitutionality of the amendment, which was passed by a simple majority; constitutional change requires two-thirds support. Ufungamano fears that, without swift and real reform, the president will be left free to steal the election for some chosen heir, or indeed fiddle yet another term for himself.

While Kenya’s version of democracy is at risk, so, not by chance, is its solvency. The second tranche of IMF loans agreed last year is already two months overdue. Mr Moi’s government has failed to fulfil any of the key loan conditions it agreed on at the time.

The heart of the problem is the demise of the Kenya Anti-Corruption Authority (KACA), an anti-graft watchdog empowered to press charges. This was the IMF’s great hope, but Kenya’s High Court in December ruled it unconstitutional. As an IMF mission came and went last month, expressing great concern and bringing no money, Mr Moi shrugged his shoulders in dismay. Haven’t these people heard of the separation of powers? he asked.

The president could resurrect KACA if he chose. But, in the past, Mr Moi has played chicken with the IMF with some success. He lost the game in 1997, when the IMF cancelled its lending programme because of endemic graft, but he won fresh promises of money last year. The new programme, brokered by Mr Moi’s old foe but personal appointee, Richard Leakey, was said by the IMF to have an underpinning of trust. More fool the Fund, one might say, after decades of broken promises to aid donors and lenders. But now, it seems, the Fund reckons it has been made a fool of once too often.

Rather than weaken its conditions, it is toughening them. If Mr Moi wants the cash, he must re-establish KACA. And get two new laws passed—and implemented: one against corruption and “economic crimes”, that would help KACA to do its job; another that would compel public servants to declare their interests. One of these bills was voted down, the other never tabled at all.

Mr Moi is playing for high stakes. The IMF programme is worth $198m. On its continuation depend a further $100m being withheld by the World Bank and $80m of bilateral loans. So does $366m of debt rescheduling. If Mr Moi chooses not to meet the IMF’s conditions, his successor, or possibly he himself, will have to run a country that is not only divided, but bankrupt.

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The Rwanda genocide trial

Accused online

Feb 8th 2001 | ARUSHA
From The Economist print edition

THE International Criminal Tribunal for Rwanda is finding its feet at last. It had a shaky start six years ago, as bad management and the sluggishness of the law threatened to destroy its credibility before its work had properly begun. A squabble with Rwanda over precisely who would go on trial also caused problems. Now things have improved: up to a point.

The court, based at Arusha in Tanzania, is charged with trying those behind the murder of about 800,000 people, the great majority of them Tutsis, in Rwanda in 1994. It has detained 44 suspects, and has already found seven men guilty: the first genocide convictions under international law. One of those tried and sentenced is Jean Kambanda, prime minister at the time of the genocide. In dealing thus with one of the top men, the court has gone a lot further than its counterpart, which looks into war-crimes in former Yugoslavia.

This week should have seen another step forward. On February 5th, shielded behind bullet-proof glass, lawyers and judges from half-a-dozen countries met to try three Rwandan journalists accused of inciting the 1994 genocide in newspaper articles, cartoons and radio broadcasts. Before and during the 100-day slaughter, the government-backed media encouraged Hutus to exterminate their “sub-human” enemies, and published lists of names of those who should be killed. A fourth journalist, a Belgian radio reporter called Georges Ruggiu, has already pleaded guilty and been sentenced to 12 years in prison.

In fact, it has been a week of stumbles and complications. Only one of the three journalists appeared in court on Monday. More disconcertingly, the other two, Hassan Ngeze and Jean-Bosco Barayagwiza, turn out to possess their own websites. Officials seized a modem from a cell in the detention centre, and identified online photographs taken inside the prison. Mr Ngeze’s website declares his innocence, offers documents related to his trial, and says that the tribunal is politically motivated and that the judges are in the pay of Rwanda’s present government. To complicate matters still more, Monday’s other absentee, Mr Barayagwiza, who also denies the trial’s legitimacy, has persuaded the court to dismiss his defence team.

The websites are a particular embarrassment. The tribunal’s registrar, Agwu Okali, says that they could influence the trial if the names of witnesses—some of which are revealed to the accused—become public knowledge. Almost all the evidence offered to the tribunal comes from people attacked during the genocide and their relatives; many of them fear what could happen if their names become known. But without their evidence the trial might grind to a halt.

It would, however, be hard to close down the websites. Friends of the accused help to run them—probably from other countries—and could easily create new ones. An attempt to close them down could produce an explosion of protest from defenders of free speech. As an alternative, it may be possible to limit the amount of information that gets on to the websites. It is thought that some defence lawyers are carrying out material from the accused. “The only way [Mr Ngeze] is getting out these things is through the lawyers,” says Mr Okali.

But challenging the defence lawyers could be risky. There are now 62 of them, and some would be happy to delay the trial in order to make the tribunal look inefficient. They can, for their part, point to prosecution failings, such as shoddy paper work and incomplete indictments of the accused. Anyway, without the defence lawyers’ co-operation, the tribunal is unlikely to complete the journalists’ trial this year, let alone tackle pending cases which involve more members of Rwanda’s former government and (for the first time) the Rwandan army.

There are also more humdrum problems. Arusha is not the ideal place for this sort of court. It is not easy to get hundreds of peasant witnesses safely from Rwanda to Tanzania. Keeping happy the 800 or so

members of the UN staff (from 87 countries) who work here and in Kigali, Rwanda's capital, is hard work. Yet in some ways things are looking up. When the tribunal first set up its own website, it depended on a small cyber café in town run by a few youths. Now it has a whole press division. Coping with the media is one task the tribunal has become used to, even if it had not reckoned on website reports emanating from inside its own cells.

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Israel's Arabs discover their identity

Feb 8th 2001 | UM EL FAHIM, GALILEE
From The Economist print edition

Get article background

Reuters

A long, long wait for no-show voters

THEY said they wouldn't, and they didn't: barely 18% of the 500,000 Arab-Israelis eligible to vote turned out. In 1999, the turnout was 75%, with 95% of them casting their votes for Ehud Barak. But things have changed, perhaps for ever.

The Arab-Israeli political parties had all called for either a boycott or a blank vote. But the mass stay-home was not a case of meek voters bowing to politicians' dictates. If anything, said Ameer Makhoul, a radical activist, who runs a union of Arab community associations, it showed the parties adapting "to the enormous consensus for boycotting among the Palestinians in Israel."

Where there was persuasion, it was moral. On election day a cavalcade of cars draped with black flags trawled through Arab villages asking voters to respect the memory of the 13 Israeli Palestinians shot dead by the Israeli police at the start of the *intifada* last October. "We will vote when they will vote," was the slogan, written in Arabic, not in Hebrew.

But the events of "Black October" do not alone explain the extent of the abstention. There seems to have been a deeper change. Arab-Israelis have long fought for civic equality with the Jewish-Israeli majority. But now, to some extent, this battle is giving way to more overtly nationalistic politics: a demand that the community's Palestinian identity be acknowledged. "We did not take to the streets in October to demand greater municipal budgets. We took to the streets as part of the Palestinian people," says Mr Makhoul.

The change reveals itself in the campaigns for restitution of property or compensation or return for those 250,000 of Israel's 1m Palestinian citizens who were displaced by the 1948 war. There is a generation of younger Palestinian leaders who have shed the complexes of "the defeat of 1948" held by their fathers. They call, sometimes from the floor of the Knesset, for Israel "to become a state for all its citizens" rather than just a Jewish state.

Above all, the boycott marked the rupture of the historical alliance between the Arab minority and Israel's Labour Party. Israel's Arabs have emerged as an independent force in Israeli society. They are no longer in anybody's pocket. From now on, say their leaders, Israel's Palestinians will work with anyone who supports their civic and national rights, whether they be to the left or right, secular or religious—or indeed the Palestinians next door in the West Bank and Gaza.

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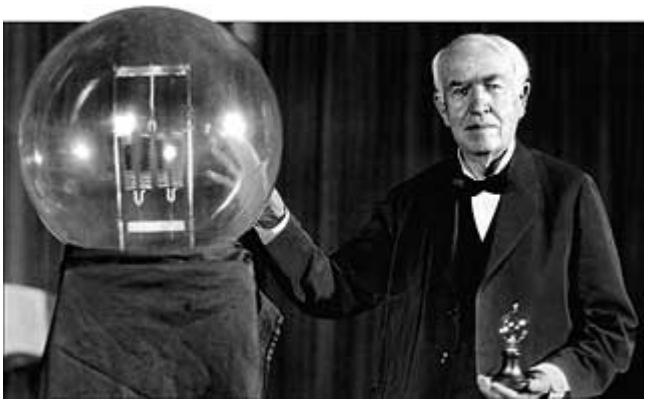
A brighter future?

Feb 8th 2001
From The Economist print edition



The world of energy is being turned upside down. The best thing governments can do is to get out of the way, says Vijay Vaitheeswaran

FOR most of the past two decades, the world has enjoyed exceptionally low and stable energy prices, but for the past couple of years or so, world oil markets have been on an unnerving roller-coaster ride: prices collapsed to around $10 a barrel two years ago, and soared to a ten-year high of over $35 last year. It was those peaks that set off a political crisis over petrol prices and shortages in America's mid-western states last summer, and that provoked the fuel riots which paralysed several European countries in September. Now oil prices are lower, but remain volatile.

Controversy over the environmental impact of fossil-fuel use has added an extra layer of complication. Last November a ministerial summit on the Kyoto Protocol, a UN treaty among industrial countries to curb global warming, broke up in rancorous disarray. Just a few weeks earlier, the California Air Resources Board had delighted greens and outraged car manufacturers by unanimously upholding its controversial "zero-emissions" mandate, which requires 10% of the new cars sold in the state by big manufacturers to meet the state's definition of zero emissions by 2004. Greenery surfaced as a big factor in the European fuel protests too, this time at the opposite end: rather than blaming the price-fixers at OPEC, most rioters—especially in Britain—attacked their own governments for levying hefty fuel taxes in the name of protecting the environment.

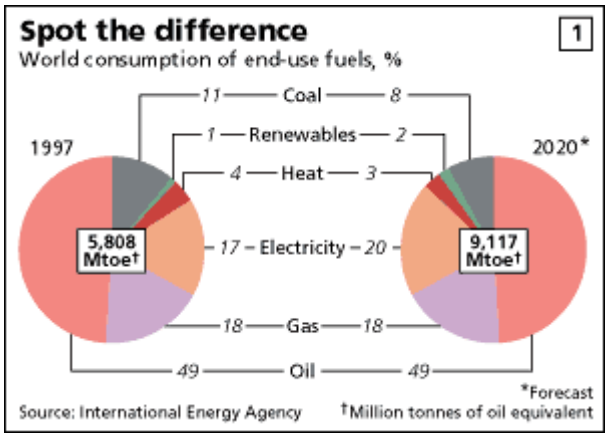
Most recently, attention has focused on the turmoil in the gas and power markets. Thanks to under-investment in gas production in recent years, low stocks and soaring demand, gas prices have skyrocketed in the past year. A number of energy gurus think the natural-gas market may be facing a decade-long problem.

Such experts usually point to California, where utilities have been brought to the verge of bankruptcy by a botched deregulation of the power industry (of which more later). This has left the firms exposed to spot prices for electricity fired by natural gas which have been as much as ten times as high as a year ago. The resulting debts, and the utilities' attempts to recover them from unwilling ratepayers, have caused a political crisis in the country's biggest and richest state and raised fears of a possible recession there.

But despite the recent volatility in energy markets, comparisons with the oil shocks of recent decades are vastly overblown. For one thing, the causes of recent energy crises are quite different from those that produced the oil shocks of the 1970s and the lesser upsets during the Gulf war a decade ago. Today's woes come at a time of peace in energy-producing regions. OPEC has been working with oil-consuming nations to try to stabilise energy prices. The spikes in natural-gas prices are causing short-term pain, but the price signals they send are already encouraging the development of more gas fields.

No need to panic

Also, in a reversal of the conventional wisdom of two decades ago, most experts now believe that oil and especially natural gas will remain plentiful for decades hence, and that the means of converting those fuels into useful energy, such as internal combustion engines and combined-cycle gas turbines, will grow ever more efficient. What is more, the world has become much less vulnerable to oil shocks: thanks to conservation, fuel switching and improvements in efficiency, oil's share of industrial countries' imports, and their economies' reliance on it, has shrunk significantly.



Three powerful factors are now combining to shape the future of the energy industry: market forces, greenery and technological innovation. None of them is new, but together they are exerting strong pressure for change. Yet the industry's incumbents tend to resist change because they have much to lose from it; and given the sector's enormous and long-lived stock of fixed assets, a turnaround is bound to take time. And, confusingly, some of the forces for change pull in opposite directions: rising environmental standards may favour renewable energy, for example, but market reforms may choke off subsidies for it at the same time.

This survey will argue that energy is indeed on the cusp of dramatic change. The sections that follow will show how the cross-currents at work today are reshaping the energy world, from the liberalisation of power markets to the greening of the world's oil giants and the advance of disruptive innovations such as fuel cells and distributed power. These changes will force energy companies to think hard about what they are truly good at, where tomorrow's competitive threats may come from, and what their customers really want. They will also help bring modern energy to poor countries that so far have been left out. Ultimately, they may even propel the world towards a cleaner and more sustainable technology: hydrogen energy.

Hand over to the market

However, whether the world realises the full potential of these prospects depends crucially on one factor: government. The invisible hand may be ascendant, but that does not mean the visible one has become irrelevant. On the contrary, during the transition to liberalised energy markets the role of regulators and officials is vitally important. And as California's sad example shows, governments can make a big difference by getting it wrong.

All three main forces of change closely involve government. In pushing for deregulation, regulators must be willing to trust market forces: they must make the rules of the game clear and refrain from arbitrary interference during the transition, yet remain on the look-out for market abuses. And ultimately they must yield most of their powers to the market.

In advocating greenery to meet their citizens' rising expectations, governments must be careful to avoid the distorting effects of such measures as excessive petrol taxes and flip-flopping environmental standards. There is a good case for some government support for renewable energy and other alternatives to fossil fuels as an insurance policy against the possibility of distant hazards such as global warming and oil depletion. However, the final test for all such technologies must remain the marketplace.

When it comes to clean technology, the most effective boost that bureaucrats can give to a sustainable

energy future is to avoid picking winners. Instead, they would do better to provide a level playing field by scrapping the huge and usually hidden subsidies for fossil fuels, and by introducing measures such as carbon taxes so that the price of fossil fuels reflects the costs they impose on the environment and human health. Governments should also ensure that incumbents do not obstruct the entry of nimble newcomers, and keep open a range of options for producing energy, including running existing nuclear plants to the end of their useful life. They should provide strong incentives for firms to invest in today's creaking electricity grids, but also remove barriers to the spread of distributed generation.

Lastly, the governments of the rich world should do much more to help the poorer part meet its energy needs by leapfrogging to clean technologies. Most of the growth in both energy demand and in emissions will soon come from developing countries. If they invest in yesterday's dirty and inefficient technologies, they will be locked into them for decades to come—and the whole world will suffer the consequences. Lack of energy, especially modern fuels, in the developing world is likely to depress the productivity of billions of its workers, and so hold back future global economic growth.

Taken together, these prescriptions suggest that successful reform will be a tricky balancing act. But without it, the future would look much dimmer.

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The slumbering giants awake

Feb 8th 2001
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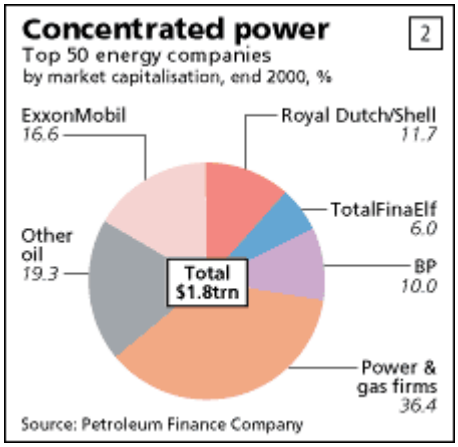
Energy companies will never be the same again



IF YOU had to name the world's largest industry, which would you pick? No, not information technology or telecommunications, nor defence or car manufacturing. Lee Raymond, the chairman of ExxonMobil, has the answer: "Energy is the biggest business in the world; there just isn't any other industry that begins to compare." By the reckoning of Booz, Allen & Hamilton, a consultancy, the turnover of the global energy business amounts to at least $1.7 trillion-$2 trillion a year. The World Energy Council, an umbrella body for various energy interests, estimates that global investment in energy between 1990 and 2020 will total some $30 trillion at 1992 prices. And it is not just size that distinguishes the industry, says Mr Raymond: "Energy is the very fuel of society, and societies without access to competitive energy suffer."

Paradoxically, its very importance has been a curse for the energy business: until recently, governments the world over have felt that it was too crucial to be left to the vagaries of the market. In many ways, they have ensured that oil, gas and electricity operated outside proper market principles. Now, albeit in fits and starts, governments everywhere are liberalising energy markets, and encouraging consolidation, cross-fertilisation and cross-border trading on a scale this business has never seen before. The resulting competition should be good for consumers, who will enjoy lower prices and more innovative services in the long run. But what will it mean for the sleeping giants and local monopolies that have dominated the energy game for so long?

It depends on whom you ask. Jeff Skilling, the chief executive of Enron, a highly successful energy brokerage, is convinced that market forces will oblige Big Oil, along with Big Coal and Big Everything Else, to split up into thousands of firms, each of which will focus on its own particular niche. Energy companies, he says, will no longer need to be vertically integrated, but will be "virtually integrated"—by the Enrons of the world, naturally, who will "wire those thousands of firms back together cheaply and temporarily". Mr Skilling sums up his vision thus: "The energy industry is on the verge of massive, massive change, and it is coming fast. We are going to hasten this fragmentation of the business, and put it back together to get lower prices for customers."

Mr Skilling sounds so much of a market fanatic that it is tempting not to take him too seriously—until you consider the breathtaking success of his strategy. In less than two decades, Enron has grown from an obscure gas-pipeline concern to the world's largest energy-trading company. Over the past decade, its revenues have increased nearly 20-fold, to over $100 billion last year. Enron's e-commerce site, which handled some 550m transactions with a notional value of $345 billion in 2000, its first full year of operation, is the most successful Internet effort of any firm in any business. Only a fool would lightly dismiss such a successful boss's vision.

A rather different view of the industry's future comes from Mr Raymond, a career Exxon man. He vigorously rejects the suggestion that Big Oil is "a sunset industry run by old dinosaurs". Two decades from now, he predicts, Exxon will still be in much the same shape as it is today, and will still be top dog. This year alone, the company intends to spend over $10 billion on proprietary technology and other investments in its vast global asset base. Not a penny of that will go on renewable energy, which Mr Raymond considers a waste of money. His firm is also unconcerned about the threat posed by fuel-cell-powered cars: his scenario planners reckon that even under the most favourable conditions, by 2020 such technology will reduce global oil consumption by less than 5%. He sums up: "I've been through, in my career, five new eras in oil, and I guess maybe a sixth will come along. But oil and gas will continue to be the dominant energy for the next 25 years."

Mr Raymond is so dogmatic in his defence of the status quo that it is tempting not to take him seriously either—until you consider the breathtaking success of his strategy, too. For years, Exxon has been the best-managed oil major in the world, with returns on capital employed far in excess of its rivals'. When the firm gobbled up Mobil two years ago, sceptics thought that the deal, like most mergers in most industries, would fail to deliver the promised benefits. To their surprise, ExxonMobil now expects merger synergies of $4.6 billion in the near term, about two-thirds higher than it had originally predicted. Clearly, only a fool would lightly dismiss such a successful boss's vision.

Perform or die

Most energy chiefs are placing their bets on the future somewhere between those two extreme positions. They are keeping their eye on the three factors that will shape that future: shareholder value, convergence and risk. Just how much the industry will change will depend on whether governments will allow these forces to take full effect, and how firms will respond to them. But judging by the impact they have had already, says David Hosein of Arthur Andersen, a consultancy, "The very expression 'an energy company' will no longer be helpful in ten or 15 years."

First of all, energy companies will increasingly be judged on their financial performance, not merely on size or volume of output, as in the past. This explains why bosses in both the oil and utilities businesses have been going for mergers, and why they will come under increasing pressure to justify the ownership of heavy assets.

These forces are already shaking up the utilities business, which in the regulated past had been the least innovative corner of the energy industry. In recent months, America's FPL and Entergy agreed on a $27 billion merger, and Germany's Veba and Viag jumped into bed together in a $17 billion deal. Many more marriages seem likely.

A good example of a rising star in this corner of the industry is Duke Energy, now one of America's biggest utilities. Although the firm has lots of physical assets, it is also expanding the role of wholesale energy in its strategy. The energy firm of the future, according to Harvey Padewer, head of Duke's deregulated parts, is "one that is agile, flexible, quick on its feet; one that holds assets not to milk and defend them, but only so far as they serve as a means to an end; and one that understands how to manage the risks of an increasingly commoditised business." That sounds pretty innovative.

All very well for utilities; but is any of this relevant to oil companies? After all, the world's biggest oil firms are still getting bigger: in the past three years, Exxon swallowed Mobil in an $82 billion deal; BP paid $54 billion for Amoco, and then added Arco; Total made a meal of Elf and Petrofina; and Chevron is in the midst of taking over Texaco. And oil prices are set by the weak but persistent OPEC cartel as much as they are by the market.

Even so, market forces are already beginning to change the oil industry. The recent wave of mega-mergers arose because institutional shareholders demanded better returns. The increasing cost, riskiness and difficulty of finding giant oil fields in ever more remote corners of the world makes a good case for the concentration of upstream assets. Four-fifths of the world's proven oil reserves remain in the hands of governments, so even merged giants such as BP and Total are small compared with Saudi Arabia's Aramco.

The urge to converge

The second big force at work in the industry is the convergence of the oil, gas, electricity and service sectors, mainly thanks to the rise of natural gas. Twenty years ago, western governments mistakenly thought that gas was scarce, and decreed it too valuable to be "wasted" in power generation. No longer. Gas burns much more cleanly than oil or coal, so concerns about the environmental and health impacts of fossil fuels have boosted its use, as have recent trends in power generation. The gold standard in power generation today is set by combined-cycle turbines; tomorrow's best bet may be micropower units such as fuel cells and micro-turbines. All of these now rely on gas. That explains why wherever wholesale markets for gas and power have been deregulated, as in America and parts of Europe, they have converged as they have taken off.

This might be expected to be good for energy trading companies such as Dynegy and Enron, and perhaps

also for electric utilities such as Duke and its peers. But why would the big oil companies, which have generally shunned gas and power in the past, now want to get involved? Only a few years ago, oilmen were arguing that the cultural differences between the different energy sectors were insurmountable. Yet those same oilmen are now converging with gusto. According to Robin West of the Petroleum Finance Company (PFC), an industry consultancy, one big reason is the relentless pressure from shareholders for financial returns. Merger synergies and unit efficiency gains are all very well, he says, but there are limits to how much managers can squeeze out of a merged firm.

With demand for natural gas forecast to grow much faster than that for oil over the next couple of decades, oil bosses are eagerly looking for ways to increase their exposure to gas-related businesses. Upstream, firms that once used to flare off gas as a useless by-product of oil exploration are now looking for ways to get it to market. One reason why BP gobbled up Amoco was to expand its small asset base in gas into a serious force. In power generation and marketing, Shell has a large presence through its joint ownership (with Bechtel, an American construction company) of Intergen. Chevron holds a big stake in Dynegy. Before its takeover by Chevron was announced last year, Texaco had contemplated a merger with Duke.

Mr West's firm has looked closely at the world's top energy firms, whether in oil, gas or power, by market capitalisation, and has found that the markets are already rewarding those firms embracing convergence.

All things to all men

Some oil majors have even dabbled in retail provision of electricity. One of them is Shell. Its boss, Mark Moody-Stuart, thinks the future will see three sorts of energy companies: asset managers such as Exxon, energy traders such as Enron, and a hybrid third sort: firms with big assets and market savvy that are not wedded to either approach but will concentrate on serving the customer in the most effective way. As it happens, Mr Moody-Stuart thinks that Shell is well placed to take the third course, which will prepare it for any longer-term shifts in the industry: "We want to meet our customers' needs for energy, even if that means leaving hydrocarbons behind."

The third force shaping the energy business is probably the scariest, as the bosses of California's ailing utilities will tell you: risk. In future, firms will live or die based on how well they manage the volatility inherent in deregulated markets—including the risks involved in making the transition to such markets. Enron's Mr Skilling puts it this way: "It's absolutely clear that volatility in the energy business is growing because of deregulation. It is irresponsible to shareholders not to hedge those risks."

Some big energy firms already have experience in energy trading, but many others may be overwhelmed. To such folk, Chuck Watson, head of Dynegy, generously offers his services: "It is extremely difficult to manage the risks inherent in deregulation: you need both the expertise and the size. Because I'm trading 10 to 20 billion cubic feet of gas a day all over North America, I can manage any supply/demand dislocations much better than any single customer." Indeed, even big energy firms are increasingly looking to the professionals: Electricité de France now relies on Louis Dreyfus, a French trading company, to help manage risks as Europe's wholesale gas and power markets slowly open to cross-border competition.

But even the most sophisticated energy firms may not be prepared for the biggest risk they face from the rise of market forces: the emergence of a truly disruptive innovation that changes all the rules of the game. As the experience of the past two decades in telecoms and computing has shown, the most powerful effect of deregulating an industry can be to open the door to venture capital, nimble entrepreneurship and technological innovation that allow the previously unimaginable to happen. Even well-run firms that dominate their industry may be knocked sideways by disruptive technologies such as personal computers and cellular telephony, as IBM and AT&T discovered to their cost.

Could that happen in energy too? The better question to ask would be not whether, but when and how. Some crazy-haired visionary may even now be at work on a wondrously efficient, completely clean power plant on wheels that will heat and light your home as well as serving as a sporty car. The industry has already seen some astonishing innovations. Why should there not be many more?

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Renewing faith

Feb 8th 2001
From The Economist print edition

AFTER the oil shocks of the 1970s, governments and companies poured huge sums into research on various forms of renewable energy. Even so, renewables (excluding big dams) still make up less than 1% of the world's commercial energy. Have they failed?

Every little helps

Not necessarily, says Dallas Burtraw of Resources for the Future, a think-tank. He has examined the forecasts made by champions of various renewable technologies over the years, and compared them with what actually happened*. What he found was that renewables generally performed as well as predicted, or better, in terms of technology and cost. But most early forecasts had assumed that fossil fuels would continue to increase in price, which turned out to be wrong.

Even so, some technologies—notably wind power—are now becoming commercially viable. Thanks to various technological breakthroughs and years of subsidies, firms such as Denmark's Vestas now manufacture wind turbines that in many places can compete on the open market. The world market for wind energy is growing at over 30% a year, albeit from a tiny base. In large parts of Denmark, Spain and Germany, wind makes up a quarter of the electricity supply. Dan Reicher, until recently America's assistant secretary of energy for renewables, reckons that in his country, where wind power has been growing spectacularly, it could provide 5% of all electricity by 2020, though others think that may be too optimistic.

The trouble with wind and other intermittent sources of energy is that they are tricky to connect to the grid and, because there are few cheap and efficient ways to store electricity, renewable electricity cannot readily be dispatched. This puts renewables at a disadvantage in liberalised markets, because green generators cannot benefit from lucrative peak spot rates.

In due course, it should be possible to fix most of these problems with new technologies: software that allows intermittent power sources to be connected safely to the grid, materials technologies that make solar cells cheaper, and energy-storage technologies such as flywheels and reverse fuel cells. At the moment, though, most renewables are probably not close enough to commercial viability to attract big money from the private sector.

What governments should do

Unless, that is, government sends the right signals. In rich countries, carbon taxes would help to boost renewables. Sunita Narain of India's Centre for Science and Environmentthinks the role of government may be even more important in poor countries, where micropower based on renewables is often cheaper than extending the grid: "The biggest obstacle in the way of renewables is not cost, but rather the state bureaucracy."

Governments can also help by adopting policies that encourage investment in clean technologies, argues Robert Gross of Imperial College in London. He and his colleagues want governments to work with industry to spur innovation and to help commercialise renewables within liberalised markets.

There remains a good case for governments to support renewables as a hedge against threats such as global warming and oil scarcity. Even fairly small investments made now can help bring forward technologies, and so create more options for the future. Mr Burtraw likens such spending to fire insurance: "Just because your house hasn't burnt down yet doesn't mean that the insurance was a waste

of money.” And yet governments content to spend vast sums on subsidising fossil fuels seem reluctant to spend small amounts on renewable energy.

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*“>Winner, Loser or Innocent Victim?”, by James McVeigh, Dallas Burtraw et al. Resources for the Future, 1999.

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Notes from a banana republic

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Energy markets are at last being liberalised. It is not proving easy

FOR the better part of a century, governments the world over have been running the power business as a command-and-control monopoly. Even in free-market America, most people have been getting their power from stodgy local utilities unencumbered by competition. This method has its merits: most of the rich world is now wired up. But it conspicuously failed in the developing countries, where over 2 billion people still have no access to electricity. And now, as concerns about the reliability and cleanliness of grid power grow, its limitations are becoming more apparent in the industrial world, too.

AP

Vain hope

That explains why governments are, at long last, beginning to extricate themselves from the energy business. About half of America's states have liberalised their power sectors, and there is now a vibrant trade in wholesale gas and electricity. The European Union, too, is deregulating its wholesale gas and electricity markets, and even in the developing world deregulation and privatisation are gaining momentum. As market forces take hold, they promise a blossoming of competition, investment and innovation.

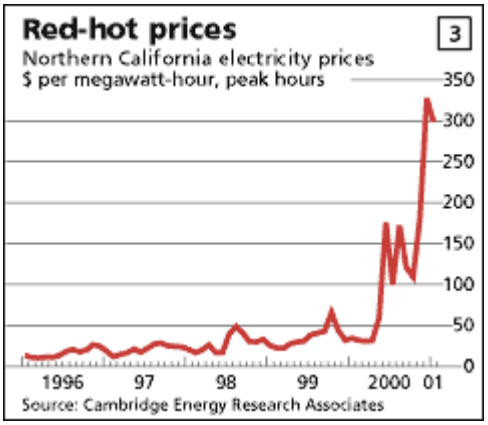
Nowhere is that promise greater than in California. It is a huge and wealthy market with a long history of progressive politics that is responsive to the demands of its people. That explains why California led the United States in liberalising its power markets in 1996. Yet far from enjoying the promised benefits of lower prices, increased reliability and cleaner energy, the state finds itself in a mess over electricity. Its two largest utilities have racked up debts of well over $10 billion in recent months, and are, in effect, bankrupt. Customers have been asked to pay more at the same time as having to endure costly and annoying power cuts. Economists are now worried that the power crisis will tip the state's flagging economy into recession, possibly dragging the rest of America with it. All this has caused a popular backlash against reform.

So what went wrong? Three things came together: a surge in demand, fierce opposition to new power plants, and the politics of pork and populism. First to demand. As computing power has spread to everything from the manufacture of silicon wafers to toasting bagels, California (like everyone else) has defied the pundits who predicted that the digital revolution would result in paperless offices and lower electricity consumption. Over the past decade, demand for power in the state has gone up by over a quarter. Some people blame this on the Internet and all its works. Dynegy's Chuck Watson reckons that electricity makes up about a third of the overall costs of running the "server farms" that are the guts of the web. Increasingly, their operators are finding it difficult to get enough power from traditional utilities. California is not alone in this. For example, Guardian iT, a technology firm now building Europe's largest web-hosting centre, near London, has decided to build its own 24MW power station because the grid could not meet its requirements.

Sceptics say it is not the digital economy itself that is responsible for the surge in demand, but the improved efficiency and increased wealth it has spread in California, which allow everybody to guzzle more power. Moreover, the state's energy planners made insufficient allowance for the demographic shifts (including heavy immigration) of the past ten years.

Despite this steep rise in demand, the state's utilities have built no new power plants in over a decade, mainly because Californians have determinedly resisted such development in their own back yard. When San Francisco's local power utility proposed installing a floating power station on a barge to avert blackouts last summer, noisy objections from greens scuppered the idea. A plan last year by

an independent power producer for a new plant in San Jose, in the heart of the electricity-starved Silicon Valley, was strongly opposed by Cisco, one of the world's largest technology companies and a huge power-guzzler. Even a proposal to tap green geothermal energy was recently blocked. Wags now say that California has gone BANANAs (build absolutely nothing anywhere near anybody).



The biggest culprit, though, is the peculiar politics of California. When officials set out to reform the power sector, their stated aim was to introduce competition and deliver lower prices for retail customers. Yet the way the reforms were designed made this unlikely to happen. One problem was that, in order to appease the state's powerful utilities, officials agreed to clauses that inhibit competition. For example, new retail entrants are burdened with part of the cost of old power stations built by incumbents, which makes it hard for them to compete on price. When free-market prices for wholesale power increased in response to last summer's supply squeeze, panicky officials ordered prices to be capped. Predictably, this caused an even worse supply squeeze this winter, because the caps discouraged generators from adding generating capacity.

Regulators actively discouraged utilities from hedging their price risks with derivatives, so the state's utilities had to buy power on the red-hot spot market. On the other hand, regulators expect the market to sort out other problems of transition all by itself. "What we have in California is not a market failure; what we have is regulatory failure," sums up Michal Moore of the California Energy Commission, one of the state's top regulatory bodies.

Nanny lets go

According to Daniel Yergin of Cambridge Energy Research Associates (CERA), a consultancy, "California, for right or wrong, has caught the attention of every politician and official in the world that is involved in energy because nobody wants to be in the position that the governor of California is in now." He worries that would-be reformers elsewhere may draw the wrong conclusion from California's debacle: that liberalising energy markets is too risky to be worth attempting. But others are more optimistic. "The good news is that few other states have copied California's mistakes, and the state can fix those mistakes; it will just take time," says Mr Watson.

Just as well, because after decades of close state control there is now enormous interest in liberalising energy markets, not just in America but in much of the rest of the world, too. Britain, Australia, New Zealand and some Scandinavian countries have had competitive markets in gas and power for some time, and the rest of Western Europe is beginning to catch up. Even in Japan, which has long viewed government involvement in energy as a national security issue, attitudes are changing, and gas and power markets are slowly opening up. But the most encouraging signs of market reform come from poor countries, which have suffered most from the existing energy infrastructure.

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Will the oil run out?

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Eventually, yes; but by then it might no longer matter

A SHIMMERING pleasure palace rises up out of the sands outside Riyadh, the capital of Saudi Arabia. It is surrounded by manicured gardens and extensive grounds in which hundreds of exquisitely groomed camels disport themselves. In this overprivileged spot, the owner, a favourite prince of the ruling family, recently threw a sumptuous banquet for foreign dignitaries. The guest of honour was the custodian of the gooey gold that makes such opulence possible: Ali Naimi, Saudi Arabia's minister of petroleum. Even Bill Richardson, then America's energy minister, took the trouble to attend.

But how long will that black gold continue to ensure such prosperity? Mr Naimi has his answer ready. "I am not in the business of forecasting or dreaming," he says with a wry smile, "but I am certain of one thing: hydrocarbons will remain the fuel of choice for the 21st century."

That puts him at odds with the growing chorus of those (including the best-known of his predecessors, Sheikh Zaki Yamani) who say that oil's grip on energy markets may soon start to weaken. The prospective scarcity of oil, the argument goes, combined with the instability of undemocratic Arab regimes, will cause a steep rise in hydrocarbons prices over the next two decades. The voracious demand for oil in the developing world will make things even worse. All this will speed the transition to cleaner alternatives.

Doomsters have been predicting dry wells since the 1970s, but so far the oil is still gushing. Vast sums have been spent and professional reputations staked on trying to guess what proportion of the total amount of conventional oil in the ground mankind has already consumed. The extreme pessimists among leading geologists, such as Colin Campbell and Jean Laherrère, argue that depletion is now close to the psychologically important half-way mark. The extreme optimists, such as the experts at America's Geological Survey, argue that this turning point is still decades away. Most take up a position somewhere in-between. Shell's Ged Davis expects the half-way mark to be reached some time between 2015 and 2030. The International Energy Agency (IEA), which represents the big energy-consuming nations, agrees that many oil fields outside the Middle East will soon mature, but does not expect a global supply crunch in the next 20 years.

In the past, pundits have rarely got their oil forecasts right. Nearly all the predictions made in the wake of the 1970s oil shocks for oil prices in 2000 were way off the mark. America's Department of Energy, for example, thought that oil at the turn of the century would reach $250 a barrel (at 2000 prices). Planners at Exxon predicted a price of $100, which was still way out, but at least their forecast for oil demand in 2000 was spot on.

One of the best forecasting records is that of Morris Adelman, a professor at MIT. He has long insisted that oil is not only plentiful, but also that it is a "fungible, global commodity" that will find its way to markets regardless of politics, making nonsense of all the talk about energy security and independence. "Back in 1973, I predicted in *The Economist* that if the Arabs don't sell us oil, somebody else will," he recalls. One reason for his optimism has been the poor quality of information about reserves in most parts of the world. It turns out that there is much more oil hidden away under the earth's surface than most people imagined back in the 1970s.

Even Exxon says it has learned one crucial lesson from earlier forecasting mistakes: it greatly underestimated the power of technology. Thanks to advances in exploration and production technology,

the amount of oil available has increased enormously. Even hitherto uneconomic hydrocarbons such as tar sands are becoming more attractive. Shell's Mr Moody-Stuart says that such "non-traditional oil will eventually behave like non-OPEC oil or marginal fields do today: if OPEC raises prices too much, these sources will help regulate the price."

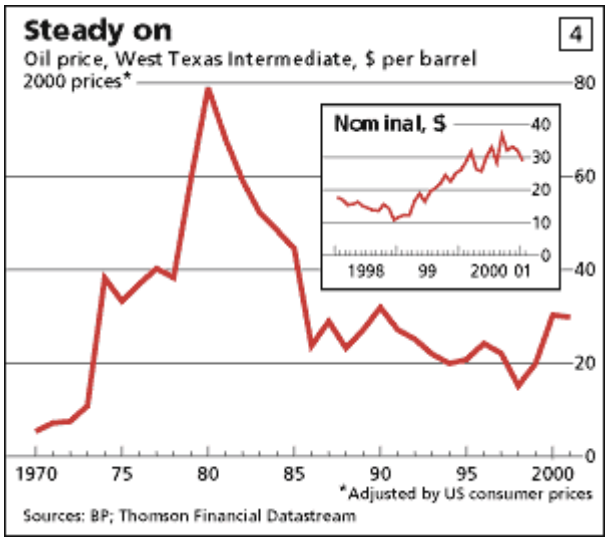
But can this pace of innovation continue? "You must be kidding: we're just getting started," says Euan Baird, the boss of Schlumberger, a giant oil-services firm. Mr Adelman, too, accepts that tomorrow's oil-exploration technology is bound to be better than today's. That is why he dismisses the idea of an oil crisis in the short to medium term. "Scarcity is still assumed even by reasonable men and middle-of-the-road forecasters, but that is wrong. For the next 25 to 50 years, the oil available to the market is for all intents and purposes infinite."

Looking for a quiet life

But scarcity is not the only reason why the world might move away from oil. The unnerving volatility of oil prices, together with growing concern about the environmental impact of hydrocarbons, is already spurring the search for alternatives. In time, such investments might well produce innovations that will break oil's near-monopoly on the global transport market. A quote now making the rounds in the energy business sums up the argument: "The stone age did not end because the world ran out of stones, and the oil age will end long before the world runs out of oil."

The past few years have provided a useful reminder that price gyrations impose real pain on economies, at both extremes. When oil prices collapsed to around $10 a barrel in early 1999, many producer countries got into dire straits. When prices soared above $30 a barrel last year, consumer economies got squeezed in turn. The worst-hit were newly industrialised countries such as Thailand and South Korea which, unlike the OECD countries, have become far more reliant on oil over the past 20 years.

There have been political repercussions, too. Several West European economies nearly ground to a halt last September as lorry drivers, farmers and other heavy petrol users revolted against high prices at the pump. America's politicians faced similar fury over heating oil last autumn, just before the elections, prompting the president to release some oil from the government's Strategic Petroleum Reserve.



Yet volatile energy prices, however irksome, are clearly here to stay. The world had been lulled into a false sense of security by the decade-long period of low and stable prices following the collapse of oil prices in the mid-1980s (except for a brief spike surrounding the Gulf war). Taking a longer view, however, volatility and unpredictability in oil prices appear to be the norm, as they are for every other commodity. Indeed, they seem worse under the fractious and ill-disciplined OPEC oil cartel than they would be either in a free market or in a strong monopoly. What is more, changes in the oil business in the past few years have had the effect of increasing volatility. According to Michael Lynch of WEFA, an economic consultancy, the decade of stable oil prices that consumers enjoyed until recently was due chiefly to a prolonged glut in production capacity. But that came to an end as demand soared and investment by OPEC producers failed to keep pace. Today only Saudi Arabia has significant spare capacity. And there has been a lot of cost-cutting in the industry recently that has left the oil market with smaller stocks and therefore much more exposed to price spikes. If the world's thirst for oil is to be met,

CERA reckons that oil supply must increase by a quarter over the next ten years, to at least 100m barrels per day. But it calculates that world production capacity today is 6m barrels per day lower than it would have been had there been no price collapse two years ago.

Mr West, the consultant, worries about bottlenecks in the refining and pipelines system. He points out that in America no one has built a new refinery in 20 years, despite strong growth in demand. This is because a combination of low margins, red tape, ever tougher environmental regulations and the NIMBY (not in my back yard) syndrome have conspired to make this part of the oil business thoroughly unattractive.

The green imperative

Asked about their biggest worry for the future, however, most industry bosses will say greenery. At the global level, their main headache is climate change. The clearest sign of change is the progress, albeit in fits and starts, of the Kyoto Protocol, a pact among industrial countries to cut emissions of greenhouse gases. For years the industry tried to ridicule the sandals-and-beards brigade and dismiss any scientific evidence suggesting that burning fossil fuels might contribute to global warming. Now it has softened its stance.

A summit last November to discuss the Kyoto treaty ended in failure, but many energy firms now accept that national restraints on carbon emissions are likely to be introduced in the medium term. Indeed, a growing band of companies, led by BP and Shell, are already preparing for the day when the price of carbon emissions is no longer zero. Mr Moody-Stuart thinks the Kyoto pact is crucial because it forces businesses to “put their best and sharpest minds on the task” of reducing carbon emissions. Other firms, notably Exxon, publicly scoff about global warming, but are quietly investing huge sums in carbon-related technology.

If oilmen are getting headaches over global warming, they are suffering migraines over local air pollution. Concerns about the environmental harm, and especially the effect on human health, of burning fossil fuels have risen to the top of the agenda in many countries. The rich world is imposing ever stricter emissions standards on refineries and power-generation plants, as well as tightening the requirements to reduce pollutants in petrol. And poorer countries too, as they gradually become better off, are putting pressure on energy companies to clean up. “Concern over the environment will not be linear, but it will be an extremely significant and irreversible force over the longer term, especially in developing countries,” says BP’s John Browne. Like its rival Shell, BP has made a big shift towards natural gas, and placed hedging bets on renewable energy and hydrogen fuel cells as well.

Drowning in oil—and loving it

So are the doomsayers right in predicting oil’s demise, even if they are wrong about the causes? Perhaps, but it might be a long wait. As the old lags of the energy business like to say, “The best substitute for gasoline is gasoline,” and it seems pretty plain that oil will be dislodged only by something that is equally cheap, easy to use and efficient—and less polluting. Even if such a thing can be found, oil could be around for decades yet, so great are the sunk investments in infrastructure, so strong the power of incumbency, so impressive the advances in fossil-fuel technology—and, quite possibly, so vast the remaining deposits.

If still in doubt, visit Al-Shaybah. Flying over the inhospitable expanses of Saudi Arabia’s Empty Quarter, you will see nothing but a desolate stretch of desert, larger than France; yet tucked away under the striking red sand dunes is one of the world’s largest oil fields. Aramco, the government oil company controlled by Mr Naimi, had to invest a total of $2.5 billion to bring the Shaybah field on stream, but since it opened in 1999, its vast output of over 600,000 barrels a day has already repaid that investment. For the next 100 years, everything it produces will be undiluted profit. And as you stare down on Shaybah, consider that Saudi Arabia could develop another dozen fields of the same size without beginning to make a dent in its proven reserves. Oil may not be tomorrow’s fuel, but today could go on for an awfully long time.

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Squeaky clean

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Fuel cells are the next big thing

NESTLING high among Colorado's snow-capped peaks is Rocky Mountain Institute, a natural-resources think-tank. Visitors in search of insights into the future of energy are shown the passive-solar atrium, the super-efficient toilet and the high-altitude banana farm. But the people who run this place do not have their head in the clouds. Amory Lovins, co-founder of RMI, is one of the world's most energetic visionaries, and like all visionaries he occasionally gets things wrong; but he has also got some big things spectacularly right. In an article in *Foreign Affairs* back in the 1970s, in the gloom after the first oil shock, he famously predicted that improvements in energy efficiency would lead to the decoupling of economic growth and energy use. At the time he was widely ridiculed, but events have vindicated him.

For some years now, Mr Lovins has been making another sweeping forecast for the future of energy, and again he is sounding fanciful: "This breakthrough will be like the leap from the steam engine to the diesel locomotive, from the typewriter to the laptop computer...it's a really disruptive technology." What is this wondrous thing? With a flourish, he unveils a large object in the centre of the room: "The HyperCar."

After nearly a decade of work, and with the support of some big industrial firms, his outfit has come up with a concept car that it believes will be the clean power plant of the future: it features all-electric propulsion, a 100% composite body, highly sophisticated electronics and software, a radically simplified and integrated design and, crucially, a fuel-cell stack to power the whole thing. Some version of this, Mr Lovins suggests, will turn the energy world upside down.

Oddly enough, only days earlier another visionary, Ferdinand Panik, had introduced a similarly hyper-green power plant on wheels on the other side of the world. At that unveiling, too, there had been talk of a revolution, and even the promise of an energy Internet: "We can use the energy unit in this car for homes or stationary power. When linked together by smart electronics, our customers can buy and trade energy freely." His boss, Jürgen Schrempp, was even more effusive: "The problem of how to ensure sufficient supply of energy that is environmentally friendly is the key challenge of the future, and we see fuel cells as the solution."

But Messrs Schrempp and Panik are not pundits on a mountain top: they are, respectively, the chairman and the chief fuel-cell expert at DaimlerChrysler, one of the biggest car makers in the world. The company has already spent $600m to develop its "new electric car" (NECAR), and Mr Panik expects it will shell out another $900m or so over the next decade to ensure its success. Daimler now expects to have fuel-cell cars on the market by 2004.

And it is not alone. Honda, Toyota and GM also say their fuel-cell cars will be ready by then, and others say they will follow. A number of car firms and oil companies have jointly opened up a hydrogen refuelling station for their demonstration cars near California's capital of Sacramento. Daimler's top people think that in 20 years' time fuel cells will power perhaps 20% of all new passenger vehicles, and possibly all urban buses. Ford's chairman, Bill Ford, recently proclaimed: "I believe fuel cells will finally end the 100-year reign of the internal combustion engine."

Of fuel cells and fallacies

Everyone agrees that fuel cells are nifty. These big batteries produce energy from hydrogen and oxygen much more efficiently than a conventional car engine does from petrol. They run nearly silently. Best of all, their only by-product is harmless water vapour. They are already taking off in stationary applications, such as power generation for clusters of homes and factories, and are likely to appear soon in portable applications: laptop computers, cellular phones, even climate-controlled bodysuits for tomorrow's soldiers.

However, says Firoz Rasul, boss of Ballard Power Systems, the world's leading fuel-cell firm, the big test will be the mass market for cars. The main obstacle is fuel infrastructure: the world is simply not organised to deliver hydrogen on demand, and may not be for decades to come. Car firms and oil companies are now wondering whether to feed fuel cells with hydrogen derived from hydrocarbons until the world is ready for the new fuel.

Nor will the incumbents be standing still. Malcolm Weiss and a team from MIT have recently completed an analysis of the vehicles likely to be in use in 2020, which concludes that fuel cells have a tough time ahead of them. This is because the internal combustion engine is not a fixed target: the conventional cars of 2020 will be far cleaner, more efficient and therefore much harder to dislodge than today's new cars (which themselves emit only about 5% of the exhaust pollutants pushed out by their early-1970s predecessors).

Yet one reason why conventional cars are getting better all the time is that hundreds of thousands of engineers the world over are working to make minute improvements to the internal combustion engine. By contrast, the number of experts working to develop fuel cells worldwide is no more than 5,000. As the promise of clean hydrogen energy moves closer, the chances are that the brightest sparks at engineering school will be drawn to this technology of the future.

For reassurance that fuel cells are well on their way, take a trip to Ballard's headquarters in Vancouver. If you get up early enough, you might even sneak a peek at Plant 1, the firm's top-secret manufacturing facility, before the workers arrive. What is remarkable about it is that it looks much like any other manufacturing plant. Fuel cells have been around for a century and a half, but they used to be strictly for mad visionaries on mountain tops. Now they can be produced in volume, just like most other pieces of machinery. The big breakthroughs have come in the past decade, during which Ballard's boffins have reduced the size of the fuel cells needed to run a small car from that of a larder fridge to that of a microwave oven.

Even the talk of "energy Internets" may not be so far-fetched. Peter Teagan, a director at Arthur D. Little, a down-to-earth technology consulting firm, puts it this way: "The question of fuel cells is much bigger than fuel cells themselves: once you have an electric drive vehicle, whether that is using fuel cells or a hybrid, you are already beyond the world of the internal combustion vehicle and the mechanical drive vehicle. It becomes trivial, even axiomatic, that energy will flow both ways."

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Here and now

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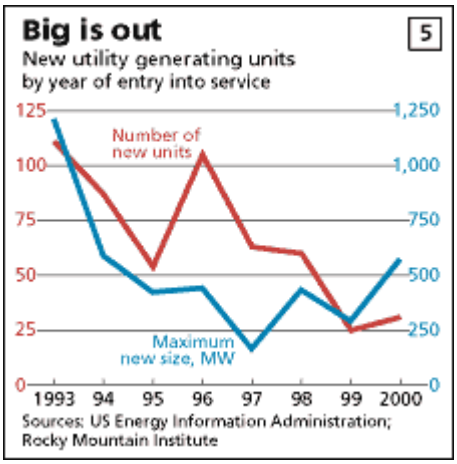
Distributed power generation will end the long-distance tyranny of the grid

FOR decades, control over energy has been deemed too important to be left to the markets. Politicians and officials have been dazzled by the economies of scale promised by ever bigger power plants, constructed a long way from consumers. They have put up with the low efficiency of those plants, and the environmental harm they do, because they have accepted that the generation, transmission and distribution of power must be controlled by the government or another monopoly.

Yet in the beginning things were very different. When Thomas Edison set up his first heat-and-power co-generation plant near Wall Street more than 100 years ago, he thought the best way to meet customers' needs would be to set up networks of decentralised power plants in or near homes and offices. Now, after a century that saw power stations getting ever bigger, transmission grids spreading ever wider and central planners growing ever stronger, the wheel has come full circle. The bright new hope is micropower, a word coined by Seth Dunn of the WorldWatch Institute in an excellent report*. Energy prices are increasingly dictated by markets, not monopolies, and power is increasingly generated close to the end-user rather than at distant stations. Edison's dream is being revived.



The new power plants of choice the world over are using either natural gas or renewable energy, and are smaller, nimbler, cleaner and closer to the end-user than the giants of yesteryear. That means power no longer depends on the vagaries of the grid, and is more responsive to the needs of the consumer. This is a compelling advantage in rich countries, where the digital revolution is fuelling the thirst for high-quality, reliable power that the antiquated grid seems unable to deliver. California provides the best evidence: although the utilities have not built a single power plant over the past decade, individuals and companies have added a whopping 6GW of non-utility micropower over that period, roughly the equivalent of the state's installed nuclear capacity. The argument in favour of micropower is even more persuasive in developing countries, where the grid has largely failed the poor.

This is not to say that the existing dinosaurs of power generation are about to disappear. Because the existing capital stock is often already paid for, the marginal cost of running existing power plants can be very low. That is why America's coal-fired plants, which produce over half the country's power today, will go on until the end of their useful lives, perhaps decades from now—unless governments withdraw the concessions allowing them to exceed current emissions standards.

While nobody is rushing to build new nuclear plants, old ones may have quite a lot of life left in them if they are properly run, as the success of the Three Mile Island nuclear power plant in Pennsylvania attests. After the near-catastrophic accident in 1979 that destroyed one of the plant's two reactors, the remaining one now boasts an impressive safety and financial record. Safety and financial success are intimately linked, says Corbin McNeill, chairman of Exelon and the current owner of the revived plant. He professes to be an environmentalist, and accepts that nuclear power is unlikely to be the energy of choice in the longer term: "A hundred years from now, I have no doubt that we will get our energy using hydrogen." But he sees nuclear energy as an essential bridge to that future, far greener than fossil fuels because it emits no carbon dioxide.

Good old grid

The rise of micropower does not mean that grid power is dead. On the contrary, argues CERA, a robust

grid may be an important part of a micropower future. In poor countries, the grid is often so shoddy and inadequate that distributed energy could well supplant it; that would make it a truly disruptive technology. However, in rich countries, where nearly everyone has access to power, micropower is much more likely to grow alongside the grid. Not only can the owners of distributed generators tap into the grid for back-up power, but utilities can install micropower plants close to consumers to avoid grid bottlenecks.

However, a lot of work needs to be done before any of this can happen. Walt Patterson of the Royal Institute of International Affairs, a British think-tank, was one of the first to spot the trend toward micropower. He argues that advances in software and electronics hold the key to micropower, as they offer new and more flexible ways to link parts of electricity systems together. First, today's antiquated grid, designed when power flowed from big plants to distant consumers, must be upgraded to handle tomorrow's complex, multi-directional flows. Yet in many deregulated markets, including America's, grid operators have not been given adequate financial incentives to make these investments. To work effectively, micropower also needs modern command and communications software.

Another precondition is the spread of real-time electricity meters to all consumers. Consumers who prefer stable prices will be able to choose hedged contracts; others can buy and sell power, much as day traders bet on shares today. More likely, their smart micropower plants, in cahoots with hundreds of others, will automatically do it for them.

In the end, though, it will not be the technology that determines the success of distributed generation, but a change in the way that people think about electricity. CERA concludes that for distributed energy, that will mean the transition from an equipment business to a service business. Already, companies that used to do nothing but sell equipment are considering rental and leasing to make life easier for the user.

Forward-looking firms such as ABB, a Swiss-Swedish equipment supplier, are now making the shift from building centralised power plants to nurturing micropower. ABB is already working on developing "microgrids" that can electronically link together dozens of micropower units, be they fuel cells or wind turbines.

Kurt Yeager of the Electric Power Research Institute speaks for many in the business when he sums up the prospects: "Today's technological revolution in power is the most dramatic we have seen since Edison's day, given the spread of distributed generation, transportation using electric drives, and the convergence of electricity with gas and even telecoms. Ultimately, this century will be truly the century of electricity, with the microchip as the ultimate customer."

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*"Micropower: The Next Electrical Era", by Seth Dunn. WorldWatch Institute, 2000.

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Power to the poor

Feb 8th 2001
From The Economist print edition

How market forces can help to meet the energy needs of developing countries

AFTER decades of intensive and expensive efforts to help the "energy poor" in developing countries, there is little to show for it all. As the World Energy Assessment (WEA), a joint effort by the United Nations and the World Energy Council, recently pointed out, "The current energy system is not sufficiently reliable or affordable to support widespread economic growth. The productivity of one-third of the world's people is compromised by lack of access to commercial energy, and perhaps another third suffer economic hardship and insecurity due to unreliable energy supplies."

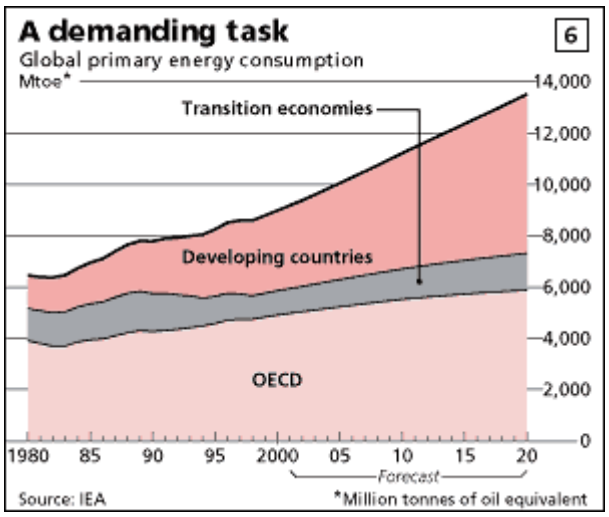
That is clearly a big problem for poor countries. Increasingly, though, energy poverty is a matter of concern for rich countries, too, and it is in their interest to help establish a sustainable energy future for all the world's inhabitants.

If nothing else, they might feel a moral obligation. Development experts estimate that some 2 billion people, chiefly in the rural areas of poor countries, lack access to electricity. But the IEA thinks that the real number may be considerably higher, because "access to electricity" is often defined as a grid extension to a village, when in many villages only a handful of people actually have access to that power. In urban areas, too, the high cost of connection prevents many households from gaining safe access to electricity.

This does not mean, of course, that they do not use energy, but that they use it in its least convenient forms—eg, charcoal, crop residues, cow dung—and usually in ways that are damaging to both human health and the environment. Such inferior fuels make up perhaps a quarter of the world's total energy consumption, and three-quarters of all energy used by households in developing countries.

According to a recent analysis by Richard Ackermann of the World Bank, the costs of using inferior fuels can be staggering: he found that the urban areas of China alone lose some 20% of potential economic output because of the effect on human health of dirty energy use. In India, indoor air pollution from dirty fuels causes as many as 2m premature deaths a year, particularly among women and girls, who do most of the cooking.

But altruism apart, the rich world also has a solid commercial motive for caring about the poor. The developing countries' voracious appetite for energy will soon have a huge effect on the availability and cleanliness of the stuff the world over, and perhaps even on the stability of energy markets. Energy consumption in the rich world, both in absolute terms and on a per-head basis, has always dwarfed that in poor countries, but in the next few decades developing economies, especially India's and China's, will start to catch up. The IEA reckons that two-thirds of the increase in energy demand between 1997 and 2020 will come from poorer countries (see chart 6). If China and India rely heavily on antiquated technology to produce power from their plentiful local supplies of coal, they will surpass even the United States as the leading emitters of carbon dioxide within decades, negating any efforts by rich countries to curb global warming. Unless rich countries help poor ones leapfrog to greener technologies, the world could soon become a nastier place for everybody to live in.



Fortunately, there are several reasons to think that the future for the world's energy poor need not be as bleak as the past. One is the liberalisation of energy markets. Another, related one is the shift away from grandiose energy projects supported by international financial institutions and aid donors. The most powerful one, though, may be grass-roots activism in poor countries. Taken together, these forces suggest that the command-and-control, fossil-fuel-based power grid may be superseded in future by a nimbler, more decentralised and cleaner energy infrastructure that is more likely to serve the needs of the poor.

The liberalisation of electricity markets now in progress in many developing countries is likely to make a big difference. Market-minded technocrats in many Latin American economies have encouraged competition in both the generation and the retail distribution of power. Argentina has also privatised YPF, its state-run oil giant, and even allowed its takeover by Repsol of Spain, its former colonial master. China has partially privatised its big oil companies. Indian states are now reforming power distribution in an effort to stop the large-scale pilferage and waste of power.

With a few exceptions (mainly China), all this may mean the death of the gigantic power project. In the past, central planners have lavished vast sums on building dams, and both nuclear and coal-fired power plants. Such projects were usually completed late and well over budget, had a much greater social impact than expected and turned out to be far less efficient than promised.

The introduction of market reforms in the production and delivery of power has injected a strong dose of reality. Most of the money for new power projects in developing countries now comes from the private sector, so projects must be financed on commercial terms—and energy investors increasingly favour small, efficient power plants fired by natural gas or other forms of distributed generation.

Liberalisation is also bringing down subsidies for fossil fuels, which will favour clean forms of distributed generation. This matters in rich countries, too, but the bias in favour of dirty energy sources is greater in many poor countries.

The view from below

However, the best reason to think that a happier energy future awaits the world's poor comes from the grass roots. Contrary to conventional wisdom, people in poor countries do care about greenery and cleaner energy, and are prepared to pay for it. Local activists all over the developing world, encouraged by like-minded people in the rich world and linked by the Internet, are clamouring for less pollution.

To make this possible, those people will have to be helped to climb up what the WEA calls "the energy ladder": from simple biomass fuels to convenient, efficient fuels (usually liquid or gaseous) for cooking and heating, and to electricity for most other uses. But decades of experience show that governments alone, however generous or well-intentioned, cannot do the job without the market.

"The developing world is just littered with examples of energy projects that have failed because donors or governments did not think about how they will be maintained and paid for," explains Christine Eibs Singer of E&Co, a charity that finances renewable energy. The key to sustainability, she argues, lies in helping local entrepreneurs create markets for the energy services that the poor actually need and are

willing to pay for, rather than what distant bureaucrats think is appropriate.

It is a widespread misconception that the poor cannot or will not pay for energy. The World Bank thinks that of the 2 billion people currently without access to modern energy, perhaps half are able to pay commercial rates for electricity; the remaining billion, reckons the agency, will need some government subsidy. Other estimates suggest that only 5-10% of those 2 billion people can afford to pay commercial rates for power, and that another 15% could probably afford to do so if credit were provided. But even these more conservative sums add up to a market of 300m-400m households.

Market-driven policies, topped up with targeted subsidies, should be able to reach many of the 1.3 billion people living in what economists call absolute poverty, with incomes of less than a dollar a day. According to development experts, households are usually willing to spend about a tenth of their monthly income on energy, including cooking fuel. Even for those in absolute poverty, who typically have a household income of $40-60 a month, that would amount to $4-6 a month. Ms Eibs Singer insists that "clean energy services could be provided for this amount on a market-driven basis, especially if you can target government programmes and subsidies at this level."

There is ample evidence that the poor do pay, often heavily, for inefficient, dirty energy—say, from kerosene, candle wax and batteries. Indeed, they often pay more per kilowatt than do middle-class, urban households or wealthy farmers who benefit from heavily subsidised grid electricity. For example, families in Peru's remote highlands on average spend about $4 a month on candles. For a bit more, they could afford the much higher-quality power offered by village power units: experts say that local entrepreneurs can turn a profit by leasing out a small, 35-watt solar unit, enough to power two bulbs and a radio, for about $80 a year.

In Yemen, dozens of tiny private generators have sprung up to service households not reached by the inadequate grid system. Although these small operators charge quite steep prices, even poor households scrape together the money rather than live in the dark. Electricity penetration in Yemen now tops 50% of households, far higher than in most countries at comparable income levels.

E&Co tries to help locals to help themselves. It invests in start-up enterprises in developing countries that want to deliver clean micropower to villages; it also advises them on how to draw up business plans, sales and distribution strategies and so on. The Tata Energy Research Institute (TERI), an Indian think-tank, uses a similar approach. In villages across India, the group has helped to train local entrepreneurs in setting up marketing chains, arrange decentralised credit and finance, and link the villages with manufacturers of village power units.

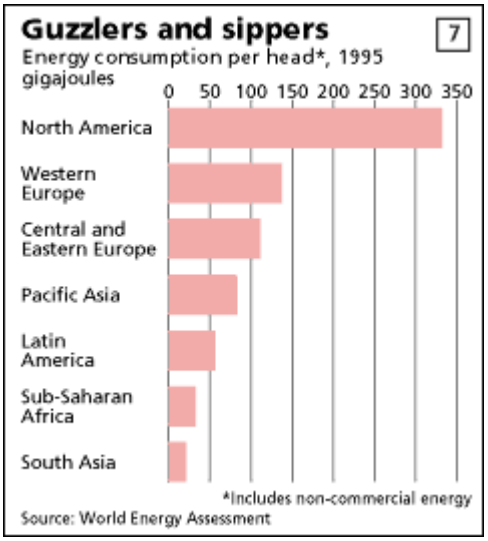
To make such schemes work, the user must pay for the services, with targeted subsidies for the very poorest. Experience shows that giving the stuff away causes a massive waste of resources. Economic incentives are also needed for the private sector to maintain and improve those energy services. Local firms have tried various methods, ranging from cash up-front and pre-paid tokens to fee-for-service or leasing. The poor, it turns out, are usually excellent credit risks, though conventional banks in developing countries still refuse to accept this. Innovative microfinance initiatives, such as lending circles, generally see repayment rates of 92% to 98%.

Village power, meet market power

But although markets can indeed help the world's poorest, they offer no silver bullets. Such successful models as E&Co and TERI are not easy to scale up to the levels of funding that the big donors are used to. All the same, some of those donors are increasingly backing the private sector in its efforts to adopt a market-based approach. The United Nations Foundation's AREED (African Rural Energy Enterprise Development) project is helping on two levels: by supporting local enterprises with business development services and seed capital, and by training its local partners in developing countries to apply market principles. Another example is the Renewable Energy and Energy Efficiency Fund, a commercial equity fund sponsored by the International Finance Corporation (the World Bank's private-sector arm), which provides the investment-stage capital for renewable energy projects in developing countries. With the help of big western utilities, insurance companies and banks, the fund has raised some $65m so far to boost renewable energy, with a focus on innovative village power schemes.

Grace Yeneza of Preferred Energy, a Philippine NGO, explains her group's work in several remote highland villages that had no access to grid electricity. Working with the *barangays*, or local councils, her

group built a micro-hydroelectric plant on the creek separating the villages in order to deliver electricity to their common areas. Donor agencies paid for the equipment, but the villagers pitched in “equity” in the form of labour and local materials. They also organised themselves into a management committee to run the plant. Those who want power for their households must pay for it. The project has not only brought power to neglected villages, but co-operation among the villagers on the power project has also ended long-running squabbles over the local creek. The future for the world’s poor may not be so dark after all.



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Beyond carbon

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The future is a gas

THE whole history of mankind's use of energy is a history of the decarbonisation of fuels. As societies have grown wealthier, they have been shifting from dirty solid fuels with a high carbon content to liquid hydrocarbon fuels with a lower carbon content, and ultimately to clean-burning gases. This is not part of any green revolution: people the world over have simply used whatever fuels have been readily available, cheap and easy to use, moving from wood and hay to coal and then oil. As energy became easier to use, it paved the way for human development, and made the world a more comfortable place for people to live in.

Burning question 8

World fuel production, tonnes, m

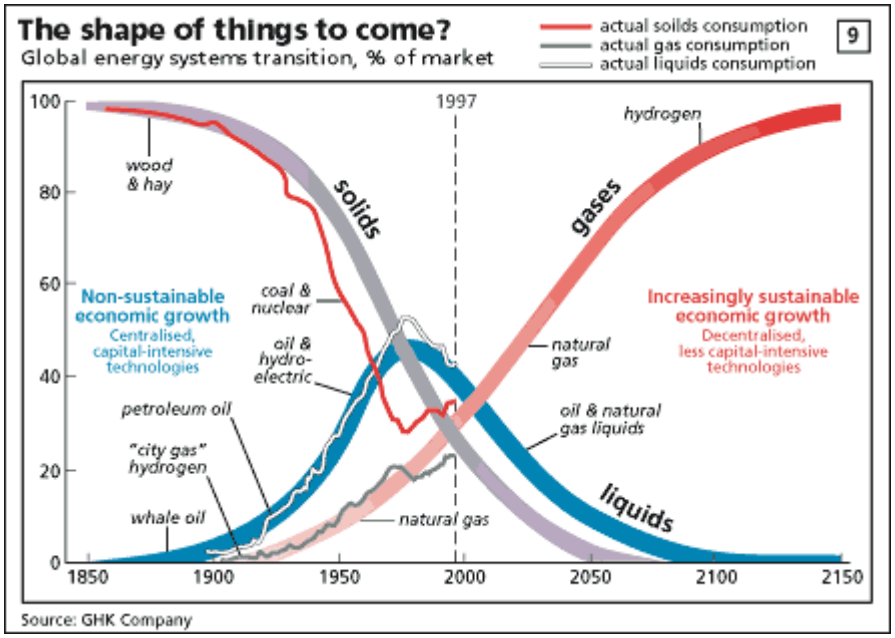
	1800	1900	1990
Biomass	1,000	1,400	1,800
Coal	10	1,000	5,000
Oil	0	20	3,000
World energy use, 1900=100	21	100	1,580

Source: John McNeill

But can this go on? John McNeill, a historian at Georgetown University, offers some thought-provoking figures in a recent history of the use of natural resources in the 20th century*. In that period, he reckons, the number of people on earth increased fourfold, but their energy use grew 16-fold. Looking back into the past, the comparisons become even more startling. The average human today uses about a hundred times as much energy as his ancestor did before the discovery of fire. Doomsayers insist that there are limits to growth, and that using so much energy is not just impractical but immoral, too.

And yet if history offers a lesson, it is that energy use should be encouraged, especially in developing countries. Energy opens the way for all the other things that make life worth living. A more suitable target for green ire would be the gross inefficiency of the world's energy systems. Lee Raymond of Exxon is passionate about this: "This world shouldn't be wasting energy, and it absolutely does waste energy; we shouldn't use any natural resource inefficiently, as eventually the world will run out."

The big question for the 21st century, then, is how best to meet the world's unrelenting appetite for energy in ways that are less harmful to the earth and to human health. This will involve government action, especially in response to people's demands for greenery. There is the growing concern about global warming, especially in rich countries, and even greater worries about the local effects of energy use on health and the environment. The best guiding principle is to level the playing field, and then to let the market get on with it. That means, for example, dismantling the many subsidies that prop up coal and other fossil fuels. It also means introducing a carbon tax or some other mechanism to ensure that prices for fossil fuels reflect the harm they do to human health and to the environment.



The most powerful force for decarbonisation throughout the ages has been the market, and it is no accident that the historic decarbonisation trend has stalled in recent decades, when governments have taken to meddling in energy markets. Robert Hefner of the GHK Company, an American energy firm, points out that: “For more than 100 years, free markets and the ingenuity of mankind worked efficiently to decarbonise our energy systems. It was only in the 1950s, when governments began to tinker with price controls and later, reacting to cries of shortages by the energy industry, allocated fuels among sectors of consumers, that we began to recarbonise the energy system.” Now, with governments around the world returning to free markets in energy, the trend away from carbon looks likely to resume. Mr Hefner argues that by 2050 consumption of natural gas and hydrogen will surpass that of coal and oil, and that by the end of this century these energy gases will have more than 75% of the global energy market, the same as King Coal in his day.

The age of hydrogen

Of all the dizzying visions of the future of energy, this may be the most powerful. After all, hydrogen is the ideal energy carrier: it is abundant, it has a simple chemistry and it produces energy perfectly cleanly. If scientists make a breakthrough in waste disposal, then it may make sense to produce hydrogen from nuclear energy. If energy companies perfect the technology needed to strip the carbon out of today’s fuels and sequester it away, then hydrocarbons could be the source of that hydrogen. In the long term, as costs come down and efficiency improves, hydrogen may even be produced from renewables such as solar energy. And on the way to such a future, natural gas offers a clean and readily available transition fuel.

Will it happen? Quite probably, though it may take 25 or 50 years, or even a century. But however long it takes, it is clear that the world is already beginning to move beyond the age of fossil fuels and towards the hydrogen era. Let the revolution roll.

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* “Something New Under the Sun: an Environmental History of the 20th Century”, by John McNeill. Penguin Books, 2000.

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To cut or not to cut

Feb 8th 2001 | NEW YORK
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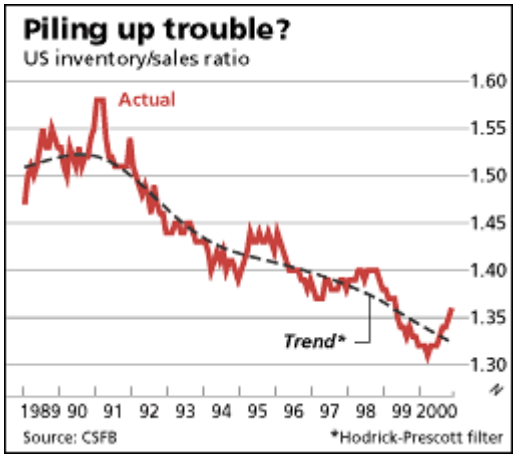
New economy or old, the slowdown is confronting corporate America with a familiar question: which costs to cut, and how deeply?

THE downturn that is already gripping America has removed the last shreds of credibility from the ultra-optimistic "new economy" theories once espoused by Wall Street's and Silicon Valley's most gung-ho believers. Thanks to wondrous new technology, the business cycle was supposedly consigned to the history books, and productivity would grow forever at a miraculous rate. So much for that: in the fourth quarter of last year, labour productivity grew at an annual rate of 2.4%, well down from the 4.3% for 2000 as a whole. Will the slowdown prompt company bosses to start cutting jobs and investment, making recession a certainty?

If anybody should doubt that the downturn is real, Cisco, a technology bellwether, this week missed its earnings expectations for the first time in over six years. According to John Chambers, its chief executive, spending by businesses on high-tech gear "could get worse before it starts to improve". Likewise, News Corporation, a media group, has just announced a loss in the past quarter. The pain is even being felt in the executive suite: Korn/Ferry, an executive search firm, has warned of weaker profits because its clients are hiring fewer people.

In past recessions, productivity plunged because businesses could not adjust quickly enough to falling demand. Firms tended to keep large inventories around to smooth out the failings in their crude demand forecasts. Crippled by excess inventories, they would lay off workers, prompting consumer confidence and spending to evaporate in a vicious recessionary circle. The new economy was supposed to be different. The extraordinary investment in information technology over the past decade brought in far more flexible manufacturing and just-in-time supply-chain systems designed to identify and respond to shocks quickly and smoothly, flattening the business cycle, if not banishing it.

Yet in recent months, inventories have risen sharply (see chart), suggesting that even today's supply chains are not perfectly nimble. How worrying is this? In previous recessions, inventory as a percentage of sales spiked alarmingly. Because this ratio has been on a strong downward trend during the past decade, the recent spike is to a much lower level than before. Nonetheless, economists at CSFB point out that, adjusted for this trend, the recent rise in inventories is the biggest since the recession of 1990-91.



Manufacturers may now be reacting more rapidly to a rise in inventories than in the past by cutting production. The National Association of Purchasing Managers (NAPM) index of new orders plunged in January to a 10-year low. This is a reliable leading indicator of future industrial production and, says CSFB, "suggests a massive response to excess inventory is in the pipeline" compared with past downturns.

This all looks rather bleak. If manufacturers get their inventories down as fast as possible, the fall in output could be large enough to ensure the economy has the two consecutive quarters of contraction that are needed to count officially as a recession. Worse, the manufacturing correction would influence managers throughout the economy to retrench, which could then deepen the recession into something even worse. The NAPM non-manufacturing orders index plunged in January after previously holding up

well, suggesting that a recession mindset may be spreading to the service sector.

Capital punishment

Two sorts of cuts now being agonised over by bosses—to investment and to the workforce—will prove crucial in the coming months. Capital spending has soared to 15.4% of America's GDP, up from 9.5% a decade ago. Over half of that is IT spending. In terms of its contribution to growth, this investment is even more significant: in the past five years, business spending on technology-related equipment and software accounted for one-third of real GDP growth.

Already, business investment has started to edge lower. Stephen Roach, an economist at Morgan Stanley, thinks it could soon fall much more rapidly. He is sceptical of claims that IT investment will prove immune from the slowdown because companies will feel they have to keep pace with technological change—he calls such talk "vendor-driven hype". More likely, he says, firms will realise they do not need to upgrade their e-mail software every other week, or invest regularly in state-of-the-art servers.

What, then, of job cuts? A recent crop of headlines about lay-offs at big companies, such as GE and DaimlerChrysler, gives a misleading impression of aggressive axe-wielding. It is true that things could yet turn fierce in the labour market. Some 134,000 jobs were reportedly eliminated in December, the most in a single month for eight years, according to Challenger, Gray and Christmas, an outplacement firm. January may have been even worse. Yet many of the announced cuts were for long-term strategic reasons—such as GE's merger integration with Honeywell—rather than because of the downturn, and will take place over several years, mostly through attrition.

The lack of job cuts so far may disappoint those new-economy theorists who reckon that today's information systems and flexible labour market should have led to a speedy response. As Ian Shepherdson of High Frequency Economics points out, if firms had cut workers by enough to maintain the sort of productivity growth they enjoyed in the first half of 2000, unemployment, currently 4.2% of the workforce, would by now exceed 5%. Instead, firms have been "hoarding" workers. Perhaps this should not surprise new-economy believers. After all, in this economy, human capital is supposed to be a firm's greatest asset, so to jettison it at the first sign of trouble would be horribly short-sighted.

Labour-market flexibility is making it easier to hoard labour. Charles Schwab, a brokerage, has demonstrated this well by telling many of its workers to take days of unpaid leave rather than cutting jobs. According to Ethan Harris, an economist at Lehman Brothers, the spread of profit-related pay and flexible working hours has enabled firms to adjust quickly to slowing demand with far fewer lay-offs than would have occurred in past downturns. The proportion of workers on flexible hours has nearly doubled since 1991, to almost 30%, and two-thirds of all workers now earn some variable pay (bonus, profit share and so on).

Even as they hoard their most valued workers, companies can more readily shed temporary staff, who now account for nearly 3% of the workforce, up from 1.3% in 1990. Manpower, America's largest temp agency, experienced flat sales in the fourth quarter of last year, down from 7% growth year-on-year in the third quarter, as demand from manufacturers plummeted. Jeffrey Joerres, Manpower's chief executive, says the first quarter of this year is also likely to be flat, although he takes some comfort from the fact that, so far this year, things have got no worse, and weakness is confined mostly to manufacturing.

The next few weeks will determine whether a correction in manufacturing turns into something nastier. What is already clear, and makes worse scenarios more likely, is that growth in corporate profits is certain to slow this year, recession or not, due to sluggish growth in demand, rising interest costs (caused by refinancings of debt secured when long-term interest rates were lower than today) and accelerating depreciation costs. According to Bank Credit Analyst, an insightful newsletter, even if America can avoid recession, annual profit growth is likely to turn negative this year; and if there is a recession on the scale of 1990-91, operating profits could fall by as much as 15%. The need to stop profits tumbling may lead company bosses, ever mindful of their share options, to act ruthlessly—and thereby make a recession not likely but certain.

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Bertelsmann and other Stiftungs

New chapter

Feb 8th 2001 | FRANKFURT
From The Economist print edition

AN OLD publishing firm in a small north German town says that in three years' time a quarter of its shares might be floated on the stockmarket. Big deal? When the company is Bertelsmann, yes it is. Despite being based in Gütersloh, the company is a global media giant, spanning books, magazines, broadcasting and music. Lately it has been trying to weave the Internet into all of them. Always it has eschewed the stockmarket.

Mohn agrees with Middelhoff

Like a handful of large German companies (see table), most of Bertelsmann's shares are owned by a *Stiftung* (foundation). Its rules ensure that the company is run not only for profit, but also for the benefit of its employees and social causes. And Reinhard Mohn, the firm's 79-year-old patriarch, has hitherto set his face against a flotation. What has changed?

The answer is the media market, and the change has been abrupt. Bertelsmann has had to try various tricks to keep up with listed competitors. The latest is an asset swap with Groupe Bruxelles Lambert (GBL), a Belgian investment company. In exchange for GBL's 30% share of RTL, a big European broadcaster, Bertelsmann is giving up 25.1% of its own shares—but only 25% of the voting rights, leaving GBL just short of a stake big enough to block important decisions. With the Mohn family and the *Stiftung* still in charge, Bertelsmann insists that it is not selling its soul, even though GBL will have the right to sell its stake on the stockmarket in three years.

A breed apart
Selected German companies controlled by foundations

Fresenius	*Medical equipment*
Bosch	*Electrical/engineering*
Carl Zeiss	*Optics*
Bertelsmann	*Media*

Source: *The Economist*

A year ago, Bertelsmann was jilted by AOL when the American company tied the knot with Time Warner. Although Bertelsmann employees were told then that the existing structure was an advantage, not a burden, in fighting back, Thomas Middelhoff, chief executive since 1998, has wanted to take Bertelsmann to market from the start.

Once the shares are floated, they will be a useful acquisition currency. Mr Middelhoff has a long wish-list, including a proposed merger (under regulatory scrutiny) of Bertelsmann's music arm with Britain's EMI and a tie-up with Napster, a reforming Internet music pirate. Bertelsmann wants to get bigger in the American magazine business. If American law ever allows foreigners to own television stations, the firm will want to expand into that market too.

People inside Bertelsmann are said to be astonished that Mr Middelhoff has persuaded Mr Mohn to change his mind. But for a while there have been signs that the company was becoming less gentle and more market-minded. Mark Wössner, Mr Middelhoff's predecessor, retired from management at 60, in line with company tradition, and took over the chairmanship of both the supervisory board and the *Stiftung*; he was eased out only a year later. When Mr Middelhoff took over, he told employees that Bertelsmann would have to behave like a public company, even though it wasn't one. The firm held its first analysts' conference last November.

Bertelsmann is following a well-trodden path for *Stiftung*-owned companies. Hertie, a department-store chain once owned by foundations, is now part of KarstadtQuelle, a listed retailer. Fewer than half of the shares in Fresenius, a maker of medical equipment, are now held by its *Stiftung*—even though the foundation has kept hold of more than half the voting rights. The management of Carl Zeiss, an optics firm, and Schott, a glass manufacturer, both owned by the same foundation, are looking at ways of

becoming joint-stock companies—which would make it possible to sell a stake.

However, Robert Bosch, an engineering and electrical-equipment firm, and the biggest remaining *Stiftung*-owned company, is standing pat. Its sales, at DM61 billion ($29 billion), are almost twice Bertelsmann's; with 200,000 employees, it has almost three times as many people on the books. A spokeswoman says that journalists keep asking the boss, Hermann Scholl, about change, but "it's not a consideration". Where Bertelsmann leads, not everyone follows.

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Software

Round three

Feb 8th 2001 | SAN FRANCISCO
From The Economist print edition

THE software industry is driven by ideological punch-ups. After the operating-system wars of the 1980s and the browser wars of the 1990s, the business is now engaged in a third big fight: over the emerging standards for software that runs on the web. In the blue corner, as usual, is Microsoft, the victor of the last two rounds. It is touting its nebulous .NET initiative, announced last year, as the "platform" on which to construct web-based software. Chief among its opponents is Sun Microsystems, a seller of both hardware and software, which unveiled its own approach on February 5th. Sun, crowed Microsoft, was racing to catch up.

In fact, the opposite is true. In many ways, .NET is Microsoft's admission that Sun was right all along—that software should be a service provided over a network, not an add-on to a PC. Sun, along with IBM, Hewlett-Packard, Oracle and others, has been pushing this "software as a service" model (which conveniently relies on expensive hardware and software, rather than cheap PCs) for years; .NET is merely Microsoft's more PC-centric take on it.

The result is an unusual consensus that the future of software lies in web-based services based on emerging open standards (ie, not owned by any particular vendor) with names such as SOAP, UDDI and XML. After years of pushing proprietary products that do not work with other companies' offerings, big computer firms are now collaborating on standards and competing on implementation.

Well, almost. Each company still has a few favoured proprietary technologies. What divides Microsoft from the rest of the industry is its attitude to Java, Sun's versatile programming language, which allows pieces of software to be snapped together and reused. Microsoft saw Java as a boon to programmers, but a threat to the dominance of its Windows operating system. Sun accused its rival of sabotage when Microsoft tried to link the two together.

The result was a lawsuit, settled last month after four years. Microsoft agreed to abandon Java in favour of its own Java-like language, called C#, and is encouraging programmers to switch to it. That threatens a schism. Programmers building web services must choose between Microsoft's .NET and the Java-based way favoured by the rest.

Sun's announcement this week was an attempt to clarify its software strategy and stand up for Java. While Microsoft bangs the drum for .NET, the Java-based approach risks losing ground until it has been given a snazzy name (programmers' bosses are suckers for that).

Sun has dubbed its software strategy ONE, which stands for Open Net Environment. Unlike .NET, a big shift in strategy for Microsoft, ONE is really just a new name wrapped around Sun's existing products, with the promise of more products to come next year. Meanwhile, Microsoft has been doing some rebranding of its own. It announced on February 5th that the next versions of Windows and Office will be named Windows XP and Office XP; the suffix stands for "experience", apparently.

IBM and Oracle have already presented their visions of web services, and Hewlett-Packard is due to do so next week, so Sun was simply falling into line with ONE. But although the names differ, all of these Microsoft rivals are essentially promoting the same platform, albeit with some minor variations (Oracle with an emphasis on databases, IBM with an emphasis on mainframes and Linux, and so on). The common use of Java and open standards means that their products can be mixed and matched more easily than in the past. It is true that this approach lacks the single-minded focus with which Microsoft is

pushing .NET. But with customers increasingly reluctant to commit themselves to a single vendor's vision, that fuzziness may prove to be an advantage.

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Face value

Light at the end of the tunnel

Feb 8th 2001
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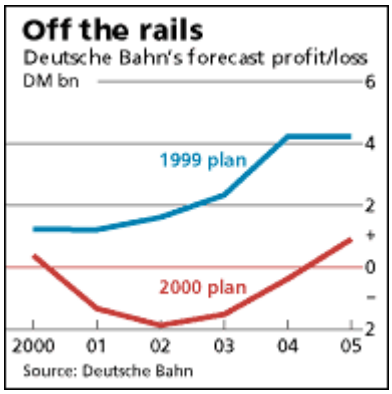
All sorts of decrepit public enterprises have been turned into thriving private firms. Hartmut Mehdorn plans to do the same for Germany's beleaguered railways

"NO SURPRISES", reads the sign on Hartmut Mehdorn's desk. "It's forbidden here," he says, whether good news or bad. Surprises, you suspect, were easier to avoid at Heidelberger Druckmaschinen, a successful maker of printing machinery, than they are at Deutsche Bahn (DB), Germany's state-owned railway company, where Mr Mehdorn has been in charge since December 1999. When he took over at Heidelberger Druck, Mr Mehdorn spent two weeks working as an ordinary employee, to observe the firm's strengths and weaknesses without being recognised. Once he was appointed to run DB, he says, a repeat was out of the question, because his face quickly became too well known.

Pity. The state of DB was one of those surprises Mr Mehdorn dislikes so much. Since being registered as a commercial (though still state-owned) company in 1994, it had seemed to be chugging along nicely. Between 2000 and 2004, according to its own plans, it was expected to rattle up profits of DM10.6 billion ($5.6 billion) and to prepare for a stockmarket flotation. But one problem after another popped up, often uncovered by managers a rung or more down from the top—alerts that should have come from the management board, four of whose members were sacked last year. Grand projects, such as a new link between Cologne and Frankfurt, were running hugely over budget and behind schedule. Old signals needed upgrading. Thousands of points needed replacing (to find out how many, retired DB employees were sent out to walk the tracks). Low expenditure flattered the accounts, and the German government was more than happy to stump up much less than the DM9 billion-10 billion a year it had promised to provide for infrastructure.



Now, says Mr Mehdorn, DB must "clear up and invest". For example, he plans to buy new locomotives, which will need less maintenance than the present ageing fleet and allow some repair shops to be closed. His revised figures, published last November, say that DB will lose a net DM4.7 billion in 2000-04 (see chart): bad enough, according to Reinhard Klimmt, the then transport minister, to take privatisation "off the table". McKinsey, the consultancy Mr Mehdorn asked to tot up the sums, reckoned that the loss could be several billion D-marks more.

However, Mr Mehdorn's plans for DB centre on reshaping services as well as costs. Like railways all over Europe, it is in competition with trucks, cars and aeroplanes and is losing more often than not. So its bosses have to decide where there might be demand for rail transport, and where there might not—unpopular though that may be. "We have to stop believing that driving a train is the most important thing in the world," Mr Mehdorn says. In essence, DB should do what pays.

That means attracting customers with fast, frequent inter-city services, supported by easily understood fares and comforts such as on-board films. On the other hand, it also means no more regional services pulling out of, say, Passau early in the morning, tracing a long, slow arc through dozens of cities before lurching late at night into Leipzig, only 280 miles away. And it means fewer local trains stopping at every country station to pick up a man and a dog, unless *Land* (state) governments pay DB enough, or find one of the growing number of private railway companies to take over the service. In goods traffic, DB has to recognise that it cannot compete with hauliers over short distances. Mr Mehdorn wants to replace its rambling network with a cheaper hub-and-spoke system.

As you would expect, Mr Mehdorn sounds optimistic. “Let’s go into cold water for two or three years, and then we’ll be OK,” he says. He believes that privatisation is possible in 2004 or 2005: after all, haven’t state-owned loss-makers such as airlines and post offices—including Germany’s own Deutsche Post—been knocked into shape and turned round? Quite right. But it is a tall order. Although Mr Mehdorn did well at Heidelberger Druck, it was in good shape when he took it on. And this time, his chances of success depend as much on the political weather as on his managerial abilities.

Or is it an oncoming train?

For a start, there is office politics. Mr Mehdorn does not get on with Dieter Vogel, chairman of DB’s supervisory board—and therefore the man who must approve or reject Mr Mehdorn’s plans. Having missed out on the top job at ThyssenKrupp, a steel company, Mr Vogel still seems to want to manage. He takes more interest in DB’s day-to-day affairs than supervisory-board chairmen usually do. This might not matter if Mr Vogel and Mr Mehdorn had similar ideas. But the tall, urbane Mr Vogel thinks that DB is in less bad financial shape than the stocky, desk-thumping Mr Mehdorn does. Mr Vogel would like to see Germany’s tracks and trains placed under separate ownership, as in Britain. Mr Mehdorn thinks that in Britain “the politicians believed they were better than the experts”, and wants to keep the system in one piece.

Politics proper also has to go Mr Mehdorn’s way. Hans Eichel, Germany’s pfennig-pinching finance minister, has made it clear that DB can expect none of the easy money heaped on other European rail companies, such as France’s SNCF (whose boss, Louis Gallois, used to work alongside Mr Mehdorn when both were senior engineers at Airbus).

But Mr Mehdorn may also be lucky. He thinks the government is “serious” about evening up the competition between rail and road, for example with taxes on long-distance lorry journeys, planned for 2003. Germany’s coalition of Social Democrats and Greens is broadly sympathetic to getting traffic off increasingly clogged roads. And with Mr Klimmt gone, following a financial scandal, the chances of getting DB to the stockmarket may have increased. The new transport minister, Kurt Bodewig, has mused in public about bringing in private capital, as a way of helping DB to get fit, rather than merely fit to sell. So Germany’s rail giant may yet get to the bourse. It might even get there on time.

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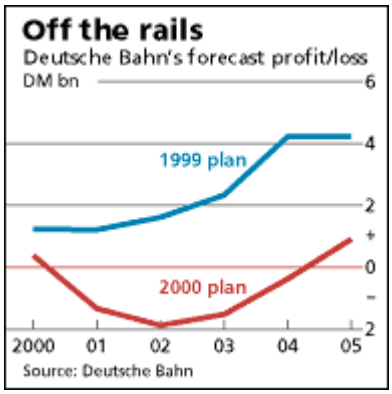

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Spanish power companies

Turned off

Feb 8th 2001
From The Economist print edition

IT WAS to be the biggest merger in Spain's business history, creating a giant by world standards. But between them Endesa, the country's number one power company, and Iberdrola, number two, control four-fifths of their home market. Eager as it was to see the birth of a national champion, Spain's centre-right government could not ignore the threat to competition. On February 2nd it fixed its conditions for a merger. Three days later, the firms' chairmen called the deal off.

The conditions were in fact softer than Spain's competition tribunal had proposed, but still tough enough to mean "unacceptable uncertainties", lamented Endesa's Rodolfo Martin Villa and Iberdrola's Iñigo Oriol. The joint company would be limited to 42% of Spain's generating capacity, 48% of distribution and 40% of the final market.

Worse—in a country where big deals are settled mainly in smoke-filled rooms, not in the market—the new group would have to sell its excess capacity by auction, not in cosy share exchanges with friendly foreign companies. On top, Spain's competition authorities would have wide powers to modify—translation, speed up—the disposals.

Worse still, the new giant would lose the subsidies that Spain's once monopolistic power industry enjoys to meet the (alleged) costs of transition to a (supposedly) competitive market. The EU has cast a beady eye on these subsidies, but this condition could still have cost some $5 billion.

And now? Markets promptly bid both shares sharply up, sensing new takeover prospects ahead. Just what prospects was unclear. Neither company is a pure power play, nor a purely Spanish one. Both have put large sums into telecoms; both, but especially Endesa, have large power interests, and larger ambitions, in Latin America.

Spain's leading oil company, Repsol, fresh from digesting Argentina's state-owned YPF, has in the past tried to lay hands on Iberdrola, which would fit nicely—if you believe not just in gas-fired power plants but in vertical integration too—with Repsol's 45% of Gas Natural, Spain's near-monopoly supplier of that fuel. But Repsol, whose earlier approaches were frowned on by the government, denies any plan to try again.

Possible foreign bidders are many. From Germany, there is E.ON—though not its rival RWE, if a bid RWE put in on February 6th wins an ongoing battle for Hidroelectrica del Cantabrico, number four in Spanish power. France's Suez Lyonnaise des Eaux and Electricité de France (EDF) might also be tempted, but EDF could expect to be ruled out by the Spanish government's dislike of state-owned companies.

Nothing says, though, that Endesa and Iberdrola will not now pursue their own ambitions to expand; Iberdrola this week hinted at just that. And there's another possibility. Though calling off the merger was strictly the two companies' business, Spain's economy minister, Rodrigo Rato, said curtly, the government would certainly have preferred it to go ahead. Imagine a bit of arm-twisting and give-and-take on both sides, and the on-off marriage just might, one day, turn out to be on again.

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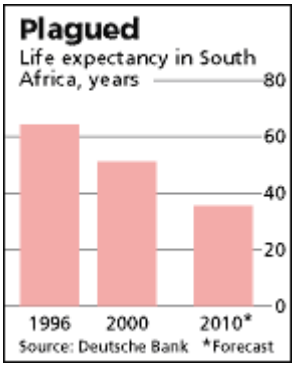
Business and AIDS

The worst way to lose talent

Feb 8th 2001 | JOHANNESBURG
From The Economist print edition

South African firms are struggling to cope as AIDS spreads



SEVERAL workers are invited on to a stage and told to stand in a line. The first is offered a piece of chewing gum. After he spits it out, the second is asked to chew it too. He refuses, prompting a discussion of when and why people are prepared to share body fluids. This is industrial theatre, one of the methods by which South African firms try to persuade their staff to sleep around less. A typical South African company can expect a fifth of its workforce to die of AIDS in the next decade, so managers have little choice but to meddle with employees' sex lives.

South Africa is not the only nation reeling from AIDS, but it is the only place that combines a relatively industrialised economy with a plague of such proportions. Managers trying to cope with the epidemic have few precedents to follow. They receive little help from government. South Africa's President Thabo Mbeki equivocates on the question of whether the HIV virus causes AIDS; his health minister distributed a document last year alleging the virus was created by westerners to kill Africans; the national AIDS-prevention campaign is incoherent.

So South African firms have to set up their own prevention programmes. Some started putting free condoms in company toilets as much as a decade ago, but this is not enough. Employees have to be induced to use them. Miners and truck drivers are particularly reckless. Miners in South Africa are traditionally migrants, living in single-sex hostels far from their families for most of the year. Their regular wages attract prostitutes. Their hazardous jobs can make them careless of other risks. By one estimate, a quarter of South African miners are HIV-positive, along with almost a fifth of workers in construction. Industries with better-educated workers are less affected: fewer than a tenth of bank employees, for example, have HIV.

Mining firms claim some success in influencing their workers' nocturnal habits, though hard evidence of changed behaviour is scanty. AngloGold, the largest gold-mining company, hands out AIDS leaflets in various African languages to miners and their girlfriends, and hires specialists to train "peer educators"—miners who teach other miners about safe sex, as well as prostitutes who teach other prostitutes.

South African Breweries (SAB) conducts role-playing exercises to show how fast infection can spread. A group of employees is given a cup each of a milky liquid, and told to act out a series of dates. When a couple decides to have "unprotected sex", they mix their liquids. One cup is invisibly contaminated at the beginning. When all are tested at the end, most usually are contaminated.

Both AngloGold and SAB offer voluntary HIV testing and counselling, and free treatment for other sexually transmitted diseases. These can be cured cheaply with antibiotics, and doing so reduces perhaps fiftyfold the chance that the HIV virus will be transmitted during sex. Anecdotal evidence suggests these efforts have been effective, but the picture is still grim. In 1998, some 24% of AngloGold's employees (including office staff) had HIV; among those who had other sexually transmitted diseases, the figure was 53%. SAB has not looked for HIV among its staff, for fear that the data could leak and deter customers from drinking its products.

The impact of AIDS on profitability is unpredictable, but probably huge. By 2015, South Africa's population is expected to be 23% smaller than it would have been without AIDS, and per capita income no higher than today. This will affect demand for everything that South African firms sell.

As workers sicken, they produce less and claim more health benefits. When they die, companies often

have to pay large death benefits to their families. Given South Africa's high unemployment, unskilled workers are easy to replace, but skilled and semi-skilled workers are not. Mondi, a papermaker, trains staff to perform several different jobs, so that if one person falls ill, the paper mill need not stop rolling. Some multinationals are taking a different tack, hiring as many as three workers for each skilled position, to ensure that replacements are on hand when trained workers die.

By one estimate, each HIV infection costs a South African firm roughly twice the infected worker's annual salary. But if the worker can be kept alive for three years longer than the average local HIV sufferer, that cost can be reduced by a quarter. Thus it can make sense to provide senior managers with costly drugs, of the sort that keep HIV sufferers in rich countries alive. For unskilled workers, several cheaper tactics are cost-effective. Drugs to prevent tuberculosis, for example, cost only $5 a year and can keep HIV-positive workers alive for three extra years.

Mondi has an impressive-sounding programme to keep HIV-positive workers healthy. The skilled have health insurance that covers even triple-cocktail therapy—the best and costliest drugs. Unskilled workers can get cheaper drugs and nutritional supplements from company clinics, and training to help them move from heavy work, such as logging, to lighter tasks. But because most workers imagine that they are not at risk, few get tested.

AIDS hurts uninfected employees too. As more workers fall ill, company health schemes will become meaner. If too many die, companies will no longer be able to compensate each bereaved family so well. For many firms, the only way to cope is to employ fewer people. Machines and subcontractors are rapidly replacing permanent staff. Mondi's forestry division, for example, has only a quarter of the employees it had four years ago. SAB's truck drivers are now largely independent contractors. AIDS is not the only reason for subcontracting: South Africa's burdensome labour laws provide another incentive. Until there is a cure, South African firms will have no choice but to be less generous when coping with AIDS.

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The Internet

Wiring the skies

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FOR some air travellers, a long flight provides a welcome escape from the incessant demands of phone, pager and e-mail. For others, even an hour unwired is torture. Connecting to the Internet via the seat-back phones found on aircraft is slow, unreliable and expensive. A number of firms are working to change that.

There are two ways to put a jumbo online. The first is to use the ground-to-air communications equipment already installed in many aircraft to provide a slow, narrowband link to the Internet. Its limited capacity (roughly equivalent to a single modem connection) makes access to the web for a planeload of people impractical, but it is enough for sending and receiving e-mail, and accessing popular web pages that are stored on the aircraft and updated every few minutes. This approach is being pioneered by Tenzing Communications of Seattle, and by Honeywell, which is merging with GE. Installation of Tenzing's system across Cathay Pacific's fleet will begin this month.

The second approach is to provide a high-speed, broadband connection to the aircraft via satellite. Boeing has developed such a system, called Connexion, which relies on an antenna originally developed for military use. This system is already used in a few private jets, and Boeing expects to begin installing it in commercial aircraft later this year. In-Flight Network (IFN), a joint venture between News Corporation and Rockwell Collins, is also taking this approach.

As well as providing high-speed access to the Internet, a broadband link also allows aircraft to receive television signals, so that passengers can watch live news and sport. But regulatory barriers and lack of satellite capacity mean that broadband access is still a couple of years away, except for aircraft flying within North America. Many airlines may therefore choose to install simpler narrowband systems first, and upgrade to pricier but more capable broadband equipment later.

How much users will have to pay has yet to be decided. Tenzing, Honeywell, Boeing and IFN are all positioning themselves as specialist Internet service providers for air travellers. The idea is that airlines will apply their own branding to these firms' services, and subscribers will then be able to log on to the Internet on other airlines fitted with the same providers' equipment. Ric Vandermeulen of Boeing believes large firms will pay to keep their employees connected during long flights. Boeing favours charging by the hour, while Tenzing and Honeywell are considering per-message, per-flight and monthly pricing. IFN will charge a monthly fee comparable to a terrestrial broadband connection, which costs $40 or less.

According to one estimate, providers of in-flight Internet access could see revenues of $70 billion over the next decade. That may be overdoing it, but there is general agreement that the business will be more lucrative than in-flight telephony, which has failed to get going. Passengers are thought to be deterred from using seat-back phones by high prices, the need to shout to be heard above the sound of the aircraft and lack of privacy. But there could be a simpler explanation: perhaps travellers on long flights simply want to relax, watch a film or read a magazine. Those hoping to profit from wiring the skies are betting otherwise.

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The fading appeal of the boardroom

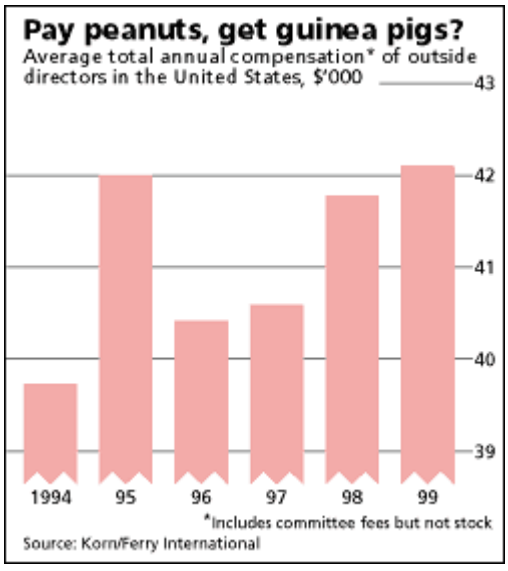
Feb 8th 2001
From The Economist print edition

Demand for outside non-executive directors is rising even as the supply of them is shrinking. Time for an increase in their pay?

A DECADE ago, 66% of all directors on American company boards were outsiders; last year that figure had risen to 78%. The California Public Employees Retirement System (CalPERS), the loudest voice in American corporate governance, argues that the only company executive on the board should be the chief executive—ie, given that the average size of the American company board is about 12, 92% of all company directors should be independent non-executives. In the past ten years, the demand for non-executives has increased by almost a fifth, and CalPERS is asking for another big increase.

The picture around the rest of the world is much the same. In Britain, where the proportion of outsiders on company boards is less than in the United States, a study published in January by PricewaterhouseCoopers (PwC), a firm of consultants, found that a majority of company directors would like to have a higher proportion of non-executives on their boards.

The desire to have more independents is even spreading to industrialising countries. And for good reason. Recent research by McKinsey suggests that investors are willing to pay a large premium, of up to 28% in the case of Venezuela and 27% in Indonesia, for the shares of what they consider to be a well-governed company—defined in this case primarily as one where a majority of the board's directors do not have management ties*. The government of South Korea, eager to pull its corporate socks up, has recently passed a law insisting that at least one-quarter of the directors of large companies must come from outside.

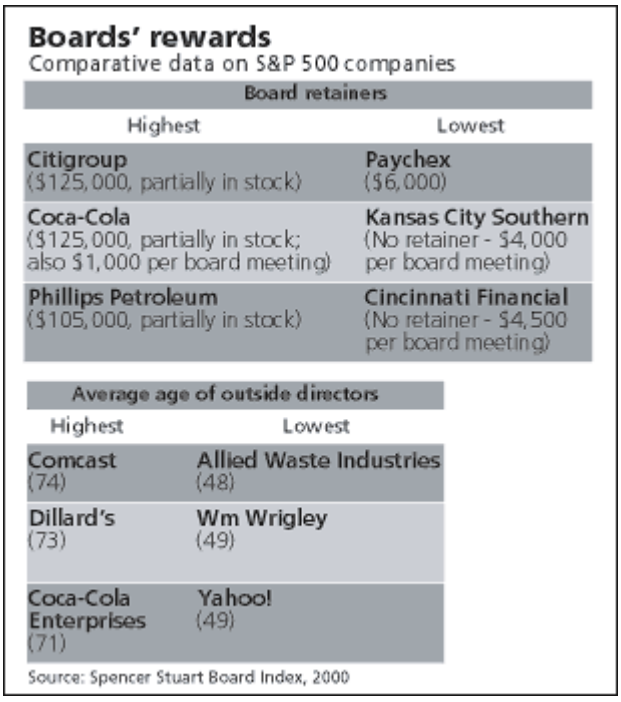


A notable exception to all this has been the rash of dotcom start-ups. Korn/Ferry International, a large recruitment consultancy, says that they have tended to do what larger old-economy companies once did. Their boards have become dominated by insiders: a mix of the current management and others with close ties to the company. As these firms mature, however, they will undoubtedly seek to change that balance.

The newly assembled board of AOL Time Warner shows the sort of non-executive team that big companies seek to put together. There is a clutch of current and former chief executives in broadly related businesses: Stephen Bollenbach, for example, who runs Hilton Hotels; and Reuben Mark, the boss of Colgate-Palmolive. Then there are a couple of grand investors, such as Frank Caufield of Kleiner Perkins Caufield & Byers, a venture capitalist; and there is a former public servant, Carla Hills (who fortunately is female and so provides the diversity that is so important in board-building these days).

In short supply

Good independent directors with this sort of background are, however, increasingly hard to come by. Not long ago, the job of an independent director was a delightful perk for important (and, often, self-important) business folk at the end of their professional lives. Corporate bosses would appoint executive directors of other companies on the principle, "You scratch my back, I'll scratch yours." This type of non-executive director would typically gather a "portfolio" of companies for his retirement. In Britain, these independents were sometimes known as "guinea pigs"—for a guinea (£1.05) and a free lunch they were happy to sleep through any chief executive's presentation of his corporate plan.



Boards' rewards

Comparative data on S&P 500 companies

Board retainers

Highest	Lowest
Citigroup ($125,000, partially in stock)	Paychex ($6,000)
Coca-Cola ($125,000, partially in stock; also $1,000 per board meeting)	Kansas City Southern (No retainer - $4,000 per board meeting)
Phillips Petroleum ($105,000, partially in stock)	Cincinnati Financial (No retainer - $4,500 per board meeting)

Average age of outside directors

Highest	Lowest
Comcast (74)	Allied Waste Industries (48)
Dillard's (73)	Wm Wrigley (49)
Coca-Cola Enterprises (71)	Yahoo! (49)

Source: Spencer Stuart Board Index, 2000

The guinea pigs have gone. "These days we are never asked to find a retired 'portfolio' director," says Barry Dinan of Hanson Green, a British search firm that claims to recruit non-executives for the boards of about a third of the FTSE 250 companies. "Yet ten years ago, that was what people expected."

But still some names crop up on half a dozen big boards. Lord Marshall, for example, the chairman of BA, is also on the boards of British Telecom, Invensys, HSBC and Inchcape. Dennis Carey of Spencer Stuart, an American search firm, says: "Most people today want CEOs or people who run divisions with significant exposure to profit and loss. But many of these people are already 'boarded-up'." To help lure such people on to their boards, companies are increasingly seeking the help of headhunters. According to an annual survey by Korn/Ferry, 73% of the Fortune 1,000 companies used a search firm in 2000 to help them fill their boardrooms, compared with only 52% the previous year. In Britain too, the proportion using search firms is rising.

Suitable candidates are becoming harder to find for a number of reasons. Some of the most desirable ones have been made unavailable: Jack Welch, the boss of GE, has made it a rule that his senior managers cannot sit on the boards of other companies. That view is gaining ground. Many big organisations are starting to limit the number of boards that their top brass can sit on as non-executives. Most of them set the limit at one, or at the very most two. If a company is going through a difficult patch, as many more may be over the next couple of years, this trend will continue: "It is hard for a CEO to take on an outside job if his company is in trouble," says Ted Jadick, head of director search for Heidrick & Struggles in the United States.

Also limiting the supply of non-executive directors are the growing demands placed upon their time. Back in 1992, the Korn/Ferry annual survey found that American directors typically spent 95 hours a year on the business of the board. Last year's survey found that figure had risen to an average of 173 hours, including preparatory work such as reading board papers and travelling back and forth to meetings. For the 82% extra time spent on the job, the average director received a 23% increase in pay.

Travel time becomes an even bigger issue when boards want to be seen to take a global perspective, as

is now fashionable: in such cases, they like to fly their board out to one of the organisation's more distant operations. Korn/Ferry found that 60% of its sample of American company directors turned down a board invitation during 2000, and a majority of them cited "lack of time" as their prime reason. Mr Carey, whose firm recruited directors for over 200 companies last year, says that ten years ago he would have been turned down by two or three directors he approached for any given board post on a "company of consequence". Today, he reckons that this has risen to six or seven rejections, and as many as ten in the case of some luckless firms.

The demands on time are rising in particular because sub-committees of the board are being given more to do. Nomination and remuneration committees are increasingly composed mainly or exclusively of non-executives; audit committees, with the key role of monitoring a company's financial position and its exposure to risk, also need a majority of independent members. In America, for example, the SEC and the NYSE stipulate that such committees be independent.

Two roles have grown increasingly important for non-executives: that of contributing to setting corporate strategy, and that of monitoring the executives. "When I first became a corporate director in the 1970s," says Robert Stobaugh, a Harvard Business School professor and an expert on governance issues, "boards intervened in times of crisis and occasionally replaced a CEO. They were never active in oversight or strategy. An article in the *Harvard Business Review* in the 1980s advocating board involvement got a flood of poison-pen letters from CEOs who did not want boards involved in strategy."

Battling the boss

The study of British boards by PwC suggests that many independents see a conflict between the roles of monitoring and of developing strategy. Too much emphasis on monitoring tends to create a rift between non-executive and executive directors, whereas the more traditional job of forming strategy requires close collaboration.

In both activities, though, independent directors face the same problem: they depend largely on the chief executive and the company's management for information. Chief executives rarely encourage direct contact between independent board members and the company's managers in the field. Moreover, given the nature of their job, chief executives tend to be tough nuts who have been granted enormous powers. Not surprisingly, that turns a good few of them into megalomaniacs. When things are going well, a board will generally put up with an unco-operative megalomaniac. But the moment things start to turn sour, independents tend to find that their ability to win change is limited. They can remonstrate, or they can fire their nuclear weapon of sacking the boss. Between those two extremes, however, there are few alternatives.

Almost invariably, independent directors postpone dropping the bomb for as long as possible. General Motors floundered for a decade while its board, mainly non-executive, failed to kick out Roger Smith or his successor, Robert Stempel. At Tomkins, a troubled British engineering conglomerate, it was a shareholder and not the board who launched the campaign that eventually persuaded Greg Hutchings, an unsatisfactory chief executive, to resign in October last year.

Such delay is not just the result of a desire to postpone unpleasantness. The moment a crisis arises, the demands on the time of the independent directors explode. As one independent chairman told John Roberts, an academic at Cambridge University who recently did a study for Saxton Bampfylde Hever, a British executive-search company:

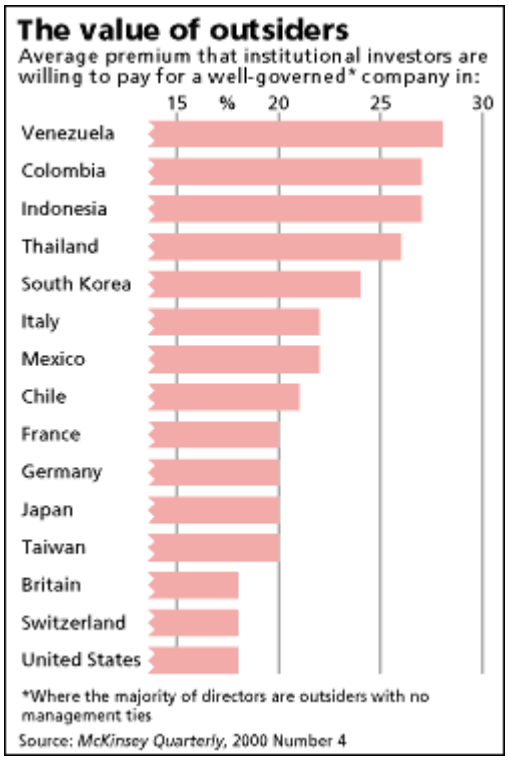
> Fire the chief executive and you're in charge for as long as it takes to get a new squad in place. During that period you've worried your suppliers, your banks, your institutions. The press are on to you like hyenas, the analysts are writing you down all over the place, and you're trying to get management back into some sort of shape to run the business just as you're discovering that things are worse than you thought.

Spot the difference

Do independent directors make a measurable difference to a company's results? There are certainly occasions when they make a splash. Warren Buffet, on the board of Coca-Cola, reportedly stopped the relatively new chief executive, Douglas Daft, from buying Quaker Oats in November 2000—although

senior Coke managers claim that they would not have gone ahead with the purchase anyway. In any case, the rising number of bosses of American companies who have been booted out in the past few years is testimony to a more active approach by the outside directors on their boards.

In truth, though, there is no decisive evidence that a majority of independent directors produces superior corporate performance. A careful analysis by Sanjai Bhagat of the University of Colorado at Boulder and Bernard Black of the Stanford Law School found that companies where at least half the directors were independent did not seem to perform any better than companies where that was not the case.† Indeed, the authors found some indications that boards with only one or two insiders actually performed worse financially than other firms.



Other research, however, reaches different conclusions. For instance, Ira Millstein, a New York lawyer, and Paul MacAvoy, a professor at the Yale School of Management, argue that the rise of the independent director is too recent for much of the research on the issue to be relevant††. They have devised a test for "active governance", based on characteristics such as the existence of formal rules for the relationship between the board and management, and the presence of a non-executive chairman or lead director. These characteristics, they claim, can be linked to superior corporate performance.

However, the structure of boards varies greatly around the world, and this makes it harder to judge the effect of non-executives. Boards in Britain and Australia, for instance, nearly always contain a mix of executives and non-executives. In Germany, on the other hand, the two sit on separate boards. One board consists entirely of executive directors and is generally the real power base, although it is supposed to be monitored by the supervisory board, which is made up mainly of independents and stakeholders, such as bankers, trade-union officials and employee representatives.

Rolf Carlsson, a Swedish expert on corporate governance, has just published a book in which he reviews board structures in five different economies—Britain, France, Germany, Japan and the United States. ("Ownership and Value Creation: Strategic Corporate Governance in the New Economy", John Wiley.) In 80% of American companies, Mr Carlsson points out, the roles of chairman and CEO are combined. "How can a board's independence and ability to carry out its governance role be guaranteed if the chairman, the head of the board, is supposed to govern himself as CEO?" he muses.

Britain's insistence that boards should contain a mix of executive and non-executive directors strikes him as equally odd. The result is that board business is a jumble of strategy, governance and operational issues. Yet his most striking conclusion is that equally successful—or disastrous—companies in different countries may operate with remarkably different board structures.

If companies do decide to put more independents on their board, where can they look for suitable candidates? One option is to turn to new pools of talent—to younger, less experienced directors, perhaps—and the evidence suggests this is already happening. Another direction to look is to academics and to retired government officials or ex-politicians: many a senior Democrat, from Bill Clinton down, has doubtless spent much of the past month or so on the telephone to executive-search firms.

Enticing

The other thing that companies might do is to pay their non-executive directors more. PwC's study found that the median annual fee for non-executives in Britain is £25,000 ($36,500), or a day rate of £1,650. In the United States, the director of a company with revenues of more than $20 billion received an average of just under $60,000 last year, not including shares. Considering what is expected of the outside director today, that is not a great deal of money.

In America, however, shares are an increasingly significant part of an independent's remuneration. Mr Stobaugh found that 98% of the largest companies in America now compensate their directors at least

partially in stock or stock options. A few (including PepsiCo) pay them exclusively in equity. In other countries, however, the equity cult has scarcely begun. PwC found that just 8% of British companies currently pay their non-executive directors in shares, partly or wholly.

Some believe that a director's financial involvement in the company on whose board he or she sits is closely correlated with performance. A study by Donald Hambrick and Eric Jackson of Columbia University business school, presented at last year's annual meeting of the Academy of Management, argued that the outside directors of companies that outperform their business sector (in terms of shareholder returns) hold four or five times as much equity as those of companies that underperform their sector.

Hermes, one of Britain's largest fund managers (with a strong reputation for shareholder activism), is keen on share ownership by outside directors. But it is not in favour of giving stock options, which it feels align a non-executive's interests too much with those of the management. In the United States, Nell Minow, an American shareholder activist whose web site, thecorporatelibrary.com, is a treasure trove of information on directors, agrees: "The single most important requirement" for an effective board, she believes, is "that all directors have a significant personal stake in the company."

Most of the evidence suggests that a stake is much more likely to influence directors' behaviour if they put up their own money to buy it. Messrs Hambrick and Jackson advocate a stake of about $500,000, and suggest that companies establish a matching fund to help directors to acquire shares at the start of their time on the board. "I've been on several boards," one independent director told them:

> I've always held small, token amounts. But now I'm on a board where the CEO encouraged us to buy and hold significant shares. I'm in for about half a million dollars, and I can tell you I'm a heck of a lot more attentive to this company than I have been to the others. If this company faces a challenge, I lose sleep at night.

That, surely, is what shareholders want of their directors more than anything else: that the fortunes of the company should matter enough to keep them awake at night—as well as during board meetings.

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* "Three Surveys on Corporate Governance", by Paul Coombes and Mark Watson, *McKinsey Quarterly* 2000 Number 4.

† "The Uncertain Relationship Between Board Composition and Firm Performance". *Business Lawyer*, Vol 54, 1999.

†† "The Active Board of Directors and Performance of the Large Publicly Traded Corporation".*Columbia Law Review*Vol 98: 1283 1998

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The swaps emperor's new clothes

Feb 8th 2001
From The Economist print edition

Do credit derivatives work when they are most needed?

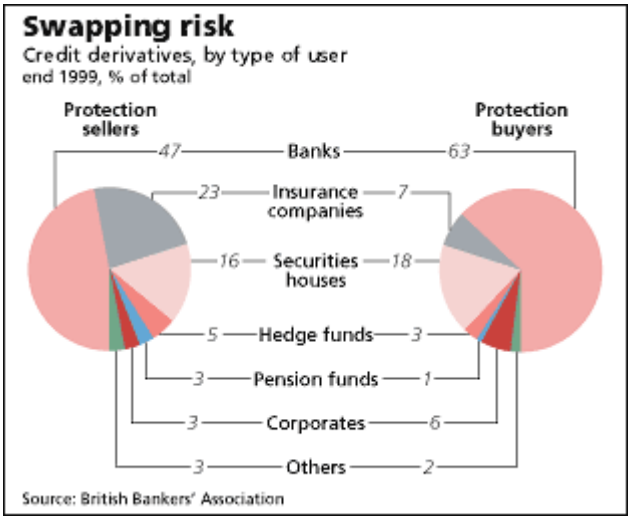
THE rate at which American companies are defaulting on their debts is soaring. Things have not yet come to such a pass in Europe, though rating agencies wonder if they will, because credit quality is declining. At times like these, bankers reach for credit derivatives, instruments that allow lenders to parcel the risk of default and pass it to somebody else. Record levels of so-called credit-default swaps, the most widespread form of credit derivative, have been bought and sold in recent months. Yet a huge and nagging doubt remains. Will credit-derivative instruments work at the crucial moment, the one they were designed to cope with—when a company (or country) defaults, or comes close to doing so? The future of a market worth $600 billion hangs on the answer.

Ten years ago the market for credit derivatives barely existed. It came into being partly because new international rules, introduced under the Basle Accord of 1988, required banks to set aside more capital against their loans. On the other hand, if banks could get another bank, for a fee, to bear the risk of a "credit event"—such as a borrower's defaulting on interest payments—then they would need to set aside only a fifth of the sum that would otherwise be required. That freed capital that could be used more profitably elsewhere.

The five banks that dominate trading in credit derivatives in London and New York talk of a time when banks will be mere originators of loans and temporary holders of credit risk. For example, an Italian bank, lending only to Italian companies, may pocket the origination fees and then quickly sell the risk; in its turn, it might then accept exposure to, say, Singaporean corporates. That could be sensible, for it diversifies the bank's assets.

Institutions can use portfolio swaps to rid themselves of the credit risk on entire classes of loans. Last year, for instance, Schroder Salomon Smith Barney arranged a transaction in which Prudential, a British insurer, got rid of the credit risk on £840m ($1.2 billion) of residential mortgages that had been sold by its Internet bank, Egg. Banks can shed credit risk in other ways too. They could, for instance, package loans as securities, and sell them to others. An advantage of credit derivatives is that banks do not have to spoil good relations with borrowers who might otherwise be offended. Borrowers need never know that the lender has bought credit protection.

Credit risks are now being shifted outside the banking sector altogether, as other kinds of financial institution are getting into the market. According to the British Bankers' Association, insurance companies accounted for 7% of the credit protection bought and 23% of what was sold in 1999 (see chart). The association expects those numbers to jump in future. Pension funds are also increasing their exposure.



Do credit-default swaps work? In practice they have sometimes failed under pressure, as the parties concerned squabbled over the definition of a “credit event”. In 1998, for instance, when Russia defaulted on its domestic debt, some buyers of default protection brought lawsuits in order to claim the payments they believed were rightfully theirs. Indonesia’s rescheduling of its sovereign debt caused similar legal tussles. In response, the industry’s trade body, the International Swaps and Derivatives Association (ISDA), came up with a new “master agreement” in 1999. This aimed to standardise credit-derivative contracts and prevent litigation breaking out again.

Misgivings about the effectiveness of credit derivatives during times of financial stress have permeated through to regulators. Richard Boulton, in charge of credit risk at Britain’s Financial Services Authority, points out that in the benign stage of an economic cycle, “It doesn’t matter so much if a bank has one or two credit-default swaps that don’t work. The regulatory concern is for a period of economic downturn when a bank may be highly dependent on them.”

Under proposed new Basle rules, therefore, credit derivatives are to receive less favourable treatment than before. Previously, in most countries, if a bank owned a credit-default swap sold by another bank, the swap would be treated like a bank guarantee, an older kind of credit protection. Now the Basle proposal says that credit derivatives need higher capital charges than bank guarantees. The ISDA is indignant.

Many of the difficulties of credit derivatives are thanks to the fragmented, heterogeneous nature of lending markets. Credit derivatives attempt, perhaps impossibly, to standardise the markets. Historical series on patterns of default do not go back far enough for accurate assessment of the risks involved; the law is unclear, because no body of rulings has been laid down; and the ISDA’s pro forma credit-derivative agreements need to be improved. But progress on such matters can do only so much. The risks underlying credit derivatives will always be idiosyncratic. Unlike other derivatives, whose payouts are triggered by movements in prices or interest rates, credit derivatives are driven by the necessarily vague notion of a credit event. Besides, a constant tension exists between the sellers of protection, who want the terms of the contracts to be as narrow as possible, and the buyers, who want them to be wide.

In the case of Conseco, a life insurer based in Indianapolis, the tension has escalated into an outright fight. When Conseco announced last September that it would restructure $2.8 billion of debt, buyers of protection called this a credit event and demanded their money. Faced with large losses, the sellers of protection decided that restructuring should no longer qualify as a “credit event”. At issue is whether the restructuring of a loan (as opposed to a plain default) should constitute such an event. The buyers of protection, which are mostly commercial banks, think it should. The sellers of protection complain that it is unfair for a lender with the power to sanction a loan restructuring to use that as a reason to demand payment on a credit-default swap. If such tussles drag on, says Simon Morris, the joint head of credit derivatives at Goldman Sachs in London, they could hamper the market’s hitherto extraordinary growth.

Restructuring is not the only area of dispute. Demergers are another. When a British utility, National Power, split into two at the end of last year, there was confusion in the credit-derivatives market over which of the two new entities the sellers of credit-default swaps were now exposed to. The market in credit derivatives has grown enormously in recent years. With bumpy times ahead, it still has a lot to prove.

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Japan's stockmarket

Support systems

Feb 8th 2001 | TOKYO
From The Economist print edition

EVERY February 3rd Japanese families throw beans from their windows as part on an age-old tradition to ward off demons and invite good fortune into their homes. Around the same time the government also performs its own good-luck ritual: propping up the stockmarkets ahead of March 31st. That is the day most companies close their financial books for the year.

This year the government has left no bean untossed in ever more desperate efforts to stop the stockmarkets' fall: on February 8th the Nikkei average fell to its lowest since October 1998, itself close to a 15-year low. A special panel of the Liberal Democratic Party (LDP) and other members of the ruling coalition has discussed measures, from using public pension funds to buy shares, to educating the school-age generation about the joys of stockmarket investment.

The stakes are high this year. Lifting the stockmarkets, even by a bit, could make all the difference to the country's banks. Many are perilously close to collapse, despite a hefty injection of public funds two years ago. Last year banks plugged the holes made by the costs of writing off bad debts by declaring gains from their share portfolios. Now stockmarkets have plunged, which means portfolio losses, not gains—and the losses might be enough to force the government to nationalise a great swathe of banks. The government owns preference shares in many of the big banks, which it got in return for injections of public funds. By law, the preference shares will have to be converted into voting shares if the banks' retained earnings fall to zero.

With an election coming up in July, the LDP wants to avoid admitting that its banking policy has been a flop. This is why it is trying to prop up the markets. A support package is about to be formally announced; still, the details of the package reveal its flaws. The masterstroke is meant to be a scheme which allows companies to buy back their shares without having to cancel them. Leave aside the fact that buying back shares runs counter to another of the government's supposed aims, that of increasing stockmarket liquidity. The danger is that buybacks without cancellation make it easier for companies to use inside information to manipulate share prices. And bear in mind that Japan lacks a powerful securities commission to monitor such shenanigans. The difficulties of monitoring were highlighted this week by reports of insider trading in the shares of Toyota Motor, which recently announced a plan to buy back and cancel ¥250 billion ($2.2 billion) of its shares.

Even from the LDP's point of view, the scheme is unlikely to help the markets anytime soon. It will almost certainly come too late to boost the stockmarkets before the end of next month, since a bill would first have to pass the Diet (parliament), and companies would need to seek shareholder approval for a buyback. Even then, argues Alexander Kinmont at Morgan Stanley in Tokyo, it is not so much a scheme to support shares as a device to increase the power of entrenched management vis-à-vis their shareholders, since it enables companies to shield themselves from takeovers. For example, a raider holding 20% of a company's shares would suddenly find himself with a smaller proportion should the company pour shares back into the market. Not surprisingly, the scheme is being advocated by the *Keidanren*, a powerful group representing business interests.

No matter how the LDP fiddles, the idea fails to address the fundamental problems dragging down Japan's markets. Share prices reflect investors' perceptions of future profits, and until real structural reform is implemented and the financial system cleaned up, firms will find it difficult to raise their profits. Sadly, the LDP's leaders appear bent on the quick fix. The silver lining is that even hardline interventionists, such as Shizuka Kamei, the powerful chairman of the party's policy council, have been

unable to stop the painfully slow realisation amongst politicians that government manipulation destroys a stockmarket's credibility. Mr Kamei started off with proposals that were even more antiquated, such as simply pumping public money into the markets. He has had to tone these down—at least until a bigger bout of panic comes along.

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Transparency in America

Farewell, fair disclosure?

Feb 8th 2001 | NEW YORK
From The Economist print edition

AP

Levitt, full and fair

THE crowning achievement of Arthur Levitt's tenure, soon to end, at the Securities and Exchange Commission (SEC) was the passage of legislation last October to bring greater transparency to the financial markets. The law requires companies to disclose "material" information to the public no later than they disclose it to security analysts and investment managers. Transparent markets are more efficient, and they are fairer to all participants. The measure, known as Regulation FD, for fair disclosure, has three goals: greater public support for security markets, greater returns for investors, and cheaper capital for companies.

Who could quarrel with that? Unfortunately, introducing notions of "fairness" and "inclusion" into a bear-pit like Wall Street, where every participant will savagely exploit any edge he can get, was never going to be easy. Recent actions suggest that unless the commission is ready to back its actions with genuine enforcement, its fair-disclosure initiative will amount to nothing.

On Jan 29th Morgan Stanley gave an old-style, restricted briefing to security analysts about managerial changes at the very top. Its defence of the restrictions (which extended to journalists and even to shareholders) was that nothing it had to say was "material". The word is defined by the SEC as being what a reasonable person would like to know—a somewhat all-embracing concept, which would seem to apply to the Morgan Stanley briefing.

Morgan says otherwise. That position raises two questions. First, why would an elite group of overworked analysts bother to attend a meeting at which a reasonable person would not learn anything he was likely to want to know? Second, why should attendance be restricted, if the information was not material? Morgan Stanley has no good answer. Since the firm is one of the biggest investment banks advising corporate America, its example is dispiriting.

On February 7th, at an investment conference in New York, a presentation was made by Oxford Health Plans, a company whose shares jumped fourfold last year before dropping. A second session was then held for the usual, restricted group of analysts and investment managers. The justification was Stanleyesque. Nothing material would be discussed. In passing, though, Oxford's investor representative characterised Regulation FD as "insane". Views on what is reasonable appear to differ.

Companies love selective disclosure, if only as a tool to punish critical analysts and reward supportive ones. Perhaps that is why Wall Street research is increasingly regarded as rubbish. Stephen Cutler, deputy head of enforcement for the SEC, says that incidents of selective disclosure "haven't escaped our attention". The SEC does not comment about investigations, but presumably one will follow into whether "material" information was disclosed or not. Some of the more cynical companies may conclude that by the time the investigations are over, Mr Levitt will be gone and a patsy will have taken his place. For the health of the markets, that view had better be wrong.

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Another look at productivity

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From The Economist print edition

New research raises doubts about the accuracy of America's productivity measures and finds encouraging signs of broad-based gains

EVERY quarter economists and investors wait anxiously for America's Bureau of Labour Statistics (BLS) to announce its latest figures on productivity. Economists care because productivity gains are linked to rising standards of living; investors care because those living standards translate into higher consumption, profits and share prices. A trio of new research papers*, however, suggests that the most widely used figures do not measure changes in productivity all that precisely. Using new tools, the last of these papers launches into the biggest debate on productivity—whether technological advances in the past decade have brought about a sea-change in productivity growth.

The measurement problem is not new. In the past five years, America has changed its methods both for reporting real GDP and for computing the consumer-price index, a trusted measure of inflation. William Nordhaus, an economist at Yale University, makes a strong case for revising productivity figures too. Starting with standard assumptions from welfare economics, he builds a simple model of the economy and then asks what the ideal measure of productivity would be.

Strictly speaking, productivity is the ratio of the extra value (the "value-added") created by a given worker to the amount of time and effort that he expends. Value-added is usually measured as the selling price of a product minus the cost of all the materials that went into making it—an easy calculation. But when industries change products annually, and workers' effort is hard to gauge, measurement is not so straightforward.

In his first paper Mr Nordhaus points out that, ideally, productivity figures ought to be constantly adjusted to reflect changes in the composition of output. He also notes a subtle but important point that emerges from the algebra: growth in productivity as conventionally measured may be distorted by changes in the allocation of inputs (labour and capital). Suppose a small amount of expenditure is moved from a less productive sector to a more productive one. This does not affect welfare but, Mr Nordhaus shows, it is falsely recorded as an increase in productivity. The figures produced by the BLS and other agencies worldwide fail in both these ways.

Mr Nordhaus's second paper suggests additional refinements. He advocates using only the income generated at every stage of the production process to calculate value-added; current figures use a combination of income and expenditure reports, which are not always updated at the same time. He also explains how ignoring output in sectors where its prices are poorly measured—such as construction, government, real estate and health services—can, paradoxically, improve the precision of productivity estimates.

Practise what you preach

The last paper in the series puts the author's prescriptions into action. He compiles output data supplied by America's Bureau of Economic Analysis—the same office that supplies the BLS—and, using techniques from the second paper, creates new productivity measures following the theoretical model of the first paper. As an application, Mr Nordhaus enters the debate on recent increases in productivity stemming from advances in information technology (IT) and high-tech industries.

Mr Nordhaus uses his new methods to show that, because of difficulties measuring the quality of workers

and capital, the BLS's estimates of productivity have overstated its contribution to living standards for the past two decades and, moreover, that the gap has not been constant. He also demonstrates that between 1995 and 1998 productivity judged by his measure did indeed rise more rapidly than at any time in the past quarter-century—about 2.3% a year compared with a previous average of 1%. Using only the productivity figures for sectors in which output is most accurately measured (which also happen to be sectors with rapid growth in productivity), the difference is roughly 4.6% against 2.3%.

Mr Nordhaus throws cold water on the idea that the economy's potential for long-term expansion has changed. He recalls that productivity accelerations such as this one also occurred in the early 1960s, early 1970s and early 1980s. Another finding is that productivity growth more than doubled between 1995 and 1998 in sectors that may use but do not produce IT products. Interestingly, furthermore, it was higher in industries whose share of overall GDP declined in the late 1990s. This runs counter to the findings of productivity scholars such as Robert Gordon of Northwestern University, whose work has often featured on this page. Mr Gordon attributes underlying growth in productivity mainly to the manufacture (as opposed to the use) of computers.

The sectors broadly identified by Mr Nordhaus as IT production did indeed exhibit stunning acceleration in productivity, from about 7% between 1978 and 1995 to over 13% in the following three years. As a whole, these sectors contributed roughly half of the recent upturn in productivity growth—nothing to sneeze at, but not nearly as much as suggested by Mr Gordon. On whether the upturn will last, Mr Nordhaus remains agnostic. He cautions against judging any long-term trends using data from only a few years.

Economic theory clearly implies that improving productivity, whether through technological change or increasing capital intensity, is the most reliable way to raise living standards. A thorough understanding of productivity, bolstered by better numbers, might therefore sharpen investors' expectations of consumption patterns and share prices. But none of Mr Nordhaus's work implies that investors should start ignoring the announcements of the BLS and others. Until his proposals are implemented, their so-called productivity figures are the only ones around, and doubtless much better than nothing.

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* "Alternative Methods for Measuring Productivity Growth", "New Data and Output Concepts for Understanding Productivity Trends", and "Productivity Growth and the New Economy". All by William D. Nordhaus. NBER Working Papers.

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South Korea

Digital manipulation

Feb 8th 2001 | SEOUL
From The Economist print edition

WITH a third of its 47m people using the Internet, South Korea is as wired a country as any, and the stockmarket shows it. Nearly two-thirds of all share transactions by value, and a third by number, are now conducted online—higher proportions than anywhere else in the world. Last year, this helped fuel a share-trading boom in the Kosdaq, the local equivalent of America's technology-heavy Nasdaq market. But the Internet is a mixed blessing: it has opened new vistas for frauds as well as for honest punters. And of the millions of Korean day-traders, some, inevitably, are crooks.

On February 5th the Seoul district prosecution agency charged a day-trader, Chung Hong Chae. Mr Chung made 20 billion won ($17m) playing the market. The prosecution says at least 2.9 billion won of this profit was achieved by manipulating the share prices of five listed firms, including Hyundai Electronics Industries and the Shilla Hotel. It believes many more shares were also affected.

According to Ryu Suk Won, the prosecutor, Mr Chung used a standard day-trading technique. He would place orders to buy a large number of shares in a company in which he already held shares. He did this with no intention of buying, and even hired five typists to key in and cancel orders almost simultaneously. But his orders would attract amateur investors, who would bid up the price, and he would cash in.

The law requires Korean stockbrokers to refuse to forward suspicious orders to the stock exchange. But online deals, which take only a few seconds to complete, are almost impossible to screen. Catching Mr Chung took eight months. In the meantime, it is alleged, he carried out 146 illegal deals.

The number of unfair-trading cases brought by the financial watchdog grew from 76 in 1998 to 95 last year. One reason for the rise is the spread of online trading, though Mr Ryu blames the corruption of Korean society as a whole. Insider trading, for example, is also rife, and figures in about a third of Mr Ryu's cases.

If convicted, insider traders and market manipulators face up to ten years in prison, or fines equivalent to three times the profit they made from illegal trading. But the courts have tended to be lenient in such cases. In January the Seoul Appeals Court handed suspended jail sentences to six fund managers convicted of taking bribes from a company chief executive in return for boosting the company's share price.

To be fair, the trade association for investment-trust companies in Korea is making an effort to clean up the market. It is encouraging its members to tighten their procedures, and threatening offenders with the revocation of their business licences. But corruption in South Korea does not result from a shortage of rules. There are many, but they are poorly enforced. Nor is it fair to blame the Internet. It has merely provided a new channel for a traditional activity: the quest for a quick buck.

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Banking in Zimbabwe

Thriving, for now

Feb 8th 2001 | HARARE
From The Economist print edition

BANKING in the world's fastest-collapsing economy is more rewarding than you might expect. The International Monetary Fund predicts that, without reforms, Zimbabwe's GDP will shrink by fully 10% in 2001, and that inflation will leap from 56% to 155%. Yet the country's banks are not merely coping: most are reporting tidy profits. In the first half of last year, Barclays' Zimbabwean subsidiary made pre-tax profits of Z$1.2 billion (US$31m) on an operating income of Z$2.6 billion. NMBZ, a local bank listed both in Harare and London, made Z$290m on an operating income of Z$670m. Things are tougher now for bankers. Yet they continue to expect profits, despite looming hyperinflation and despite government-sponsored gangs of machete-wielding thugs that roam the countryside, seizing private property.

Reuters

Banker to thug: make my day

It helps that bankers are not being victimised in the same way as Zimbabwean farmers. President Robert Mugabe thinks he can win support by seizing white-owned farmland and distributing it to blacks, but there are few votes to be won by doing the same to banks. The poor are hungry for land, not for jobs as credit officers.

What is more, the troubles in the real economy did not arrive without warning. When Mr Mugabe started threatening to grab white farms a couple of years ago, banks reduced their lending to farmers. Those whose land was earmarked for grabbing could not get credit unless they had other forms of security. Now that the economy has imploded, the more conservative banks have stopped lending to all but the bluest-chip firms and the wealthiest individuals.

How do the banks make their money? A big earner last year was lending to the government. After years of waste and lax discipline, Mr Mugabe is desperate for cash. The IMF estimates that the government took in 27% of GDP in taxes last year, and spent 50% of GDP. To make up the shortfall, the government issued treasury bills yielding up to 70%. The difference was vast between what banks paid their depositors and what they could make putting depositors' money into treasury bills. Savings accounts paid between 10% and 40% last year, down to 10-20% this year. Current accounts pay next to nothing.

Zimbabwean banks prosper in other ways. Barclays, for instance, sometimes buys preference shares in corporate clients, instead of lending to them. Instead of interest, the bank gets dividends, which are less heavily taxed. Stanbic, a South African bank with several branches in Zimbabwe, offers "zero-cost" currency swaps, which are anything but. A firm that needs hard currency gets it by swapping Zimbabwe dollars at the prevailing rate. After an agreed period, the bank buys back American dollars for Zimbabwean dollars—at the earlier exchange rate. The bank has been earning local interest rates on the local dollars, whilst the client has shouldered the currency risk. With an ever-sinking local currency, this has been a one-way bet for the bank. Local manufacturers, desperate for hard cash, put up with it.

This year will be harder for banks. The yield on treasury bills has fallen to 14%, and the government plans to raise money in other ways. One plan is to force pension funds to buy ten-year bonds paying just 15%. That is, pensioners will be mugged to pay for Mr Mugabe's war in Congo. Another plan, announced in mid-January, is that banks will be forced to take some of the reserves they are currently obliged to lodge, at zero interest, with the central bank and lend them to "productive" enterprises, meaning exporters, miners, farmers, tourism firms and manufacturers. Exporters will be able to borrow at 15%, others at 30%.

That sounds fine for the banks—given Zimbabwe's high inflation, both those rates are negative in real terms, but even 15% is better than nothing. The trouble is, while firms may borrow, they will not produce much more so long as fuel supplies remain erratic, farms are over-run by homicidal goons, and tourists are too scared to visit Victoria Falls. So the main effects of the plan will be to stoke inflation.

As the country continues to unravel, some of the weaker banks may fail. The IMF estimates that a fifth of the loans on commercial banks' books last September were bad, and given that some banks lend to cronies of the ruling party, the proportion is rising fast. Zimbabwean depositors face an increasingly sorry choice. They can put their money into safe banks at derisory rates of interest, and watch inflation munch it. Or they can put it into dodgy banks, where they will get higher rates of interest, and maybe lose the lot.

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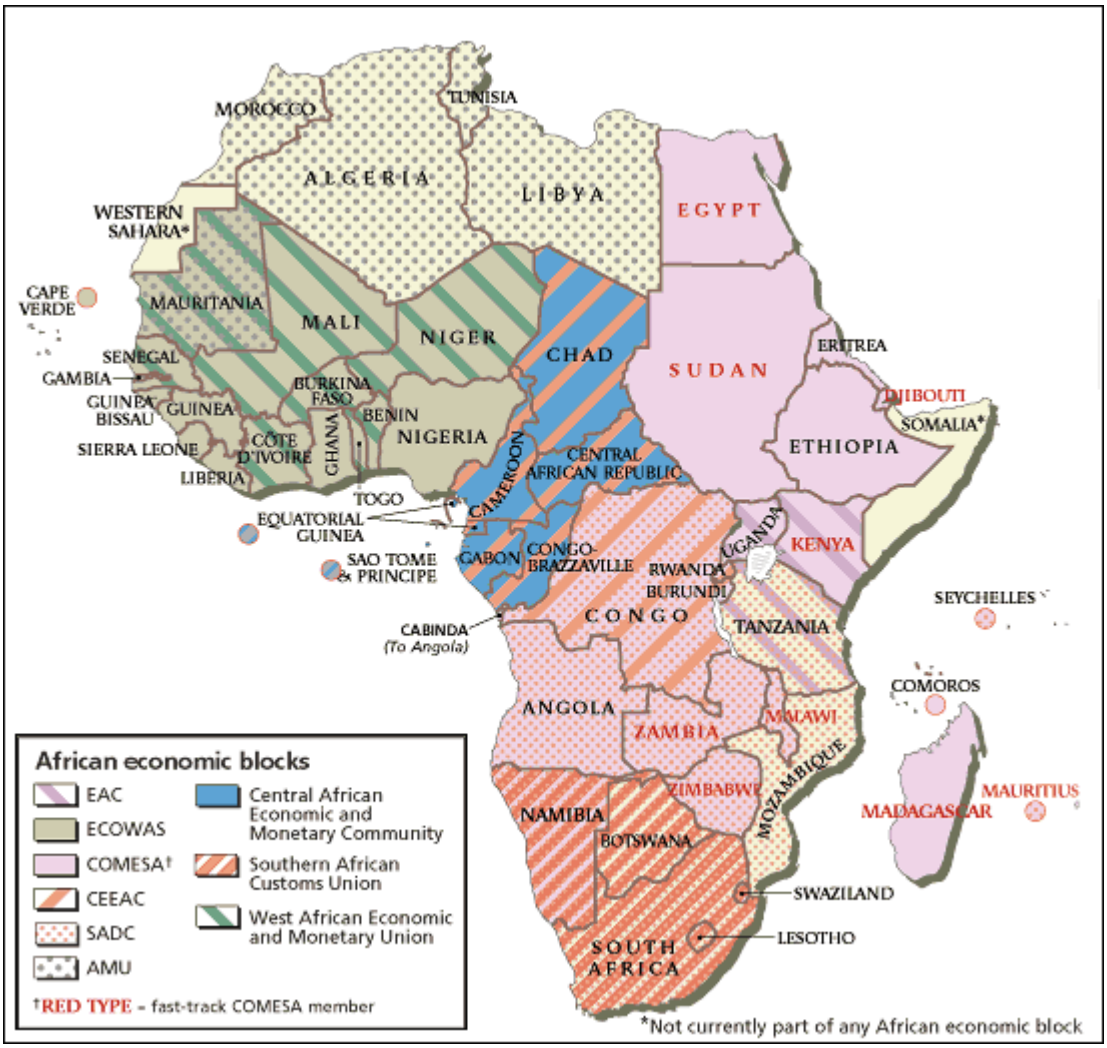
Afrabet soup

Feb 8th 2001
From The Economist print edition

TRUCKS can wait for days at African border crossings whilst their goods clear customs. Shipments are delayed, and the drivers frequently spend the wasted days in AIDS-ravaged roadside brothels. With the revival this month of the East African Community (EAC), the continent boasts at least 11 economic blocks seeking to solve this and other problems. But progress is slow—partly thanks to the crazy quilt of overlapping memberships. The blocks are far from fulfilling their potential, and far from giving Africa its longed-for voice in world trade.

African countries want better access to American and European markets for farm and textile products. America and Europe want to open service markets and protect intellectual property in Africa. Most of Africa's economies are too small on their own to negotiate with America and Europe. Alliances are the obvious solution.



Africa has been experimenting with economic integration for half a century. The fruits of those efforts (see map, if your eyes can take the strain) have included big, multipurpose groups such as the Economic Community of Western African States (ECOWAS), the Common Market for Eastern and Southern Africa (COMESA), the Economic Community of Central African States (CEEAC), the Southern African Development Community (SADC) and the Arab Maghreb Union (AMU). They have also included smaller, less globally oriented blocks such as the Economic Community of the Great Lakes Countries, the Mano River Union and the EAC.

Global credibility has been hard to come by. Many alliances lack the authority and bureaucratic sophistication to deal with the big powers. Moreover, the blocks can lie dormant for years at a time—as the EAC did—while their members endure political turmoil. As a result, Africa's alliances have concentrated more on liberalising trade within the region than with the rest of the world. What progress there is has been slow. Protectionism is easy to justify, since less-developed, less-diversified economies are also less able (it is argued) to weather the transition to free trade.

For this reason, separate blocks of more liberalised countries exist within the larger ones. Most countries are members of more than one block. When it comes to extra-African trade agreements, these multiple memberships cause problems. Take Zimbabwe. It is a fast-track member of COMESA and part of SADC. Suppose SADC signs a trade agreement with Europe. Goods can be shipped from Europe to Zimbabwe—and onwards, tariff-free, to other fast-track COMESA countries, perhaps to Kenya, from which the goods could also circulate inside the EAC. This chain of unanticipated liberalisation, though good for trade, might make an initial agreement with Europe harder to sign.

The biggest gain from Africa's regional alliances, all the same, is likely to be in promoting the spirit of free trade. Experience in negotiation and administration on the regional level will translate into improved competence at the global level. It is partly for this reason that the World Trade Organisation gives cautious support to Africa's efforts, even though it emphasises the primacy of the multilateral system.

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Capital gains

Feb 8th 2001 | NEW YORK
From The Economist print edition

FOR a company's bosses, listing shares on the New York Stock Exchange (NYSE) is a good excuse for a party, kicking off with the chance to ring the famous bell that starts, and ends, the day's action on the trading floor. Few bosses would want to see the noisy throng make way for silent computerised trading: no fun in that. Yet automated trading would make it much cheaper for companies to raise fresh capital. That, at least, is what two economists, Ian Domowitz and Benn Steil, conclude.*

EPA

Hey, you're history

The study examines share trading around the world in 1996-98, a period when computer-based systems known as ECNs (electronic communications networks) became important in the trading of listed shares on the Nasdaq market in America, and many other exchanges made better use of automation. The study found that on balance fully automated trading—where computers match buyers and sellers—was as much as one-third cheaper than traditional trading on the New York Stock Exchange and even the Nasdaq.

Thanks in part to computers, across 42 countries, trading costs fell by an average of 16.4%. This reduced firms' cost of capital by an average of 2.75%. There are reasons besides cheaper trading costs why the cost of raising capital may have fallen sharply during this period. Perhaps investors became readier to take risks. Across the countries studied, cheaper trading accounted for only about a quarter of the total decline, according to the study.

The results were much more dramatic for America, where trading costs fell by 53% during this period, compared with 17% in Europe. In America, for firms in the S&P500 index, the cost of capital fell by 9%. Messrs Domowitz and Steil reckon that at least four-fifths of the reduction could be down to lower trading costs.

In Europe, lower trading costs accounted for around half of the fall in the cost of capital, of up to 5.5%. Although European markets were more automated during this period than their American counterparts, their trading costs (including commissions, and taking into account the effect on price of the size of trades) were three to four times higher. The main reason was that European intermediaries were far less efficient than in America.

What would happen if all the world's markets were fully automated, and inefficient intermediaries were no more? The authors calculate that on the Nasdaq, where only 30% of trades are currently done through ECNs, full automation would lower trading costs by a further 23%—reducing the cost of capital to firms listed on it by another 3.6%. On the NYSE, and other American regional exchanges, where automated trades account for only 5% of volume, full automation would cut trading costs by 27% and companies' cost of capital by 4.2%.

As for Europe, removing inefficient intermediation and further automating trading would cut trading costs by 50% and the cost of capital by a further 7.8%. All of which suggests that listed companies should be pushing for automated trading of their shares as soon as possible. Ring that electronic bell!

* "Innovation in equity trading systems: the impact on transactions costs and cost of capital", in "Technological Innovation and Economic Performance". By Richard Nelson, David Victor and Benn Steil, Princeton University Press, forthcoming.

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Genetically modified weaklings

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From The Economist print edition

GM crop plants are less weed-like than weedy

Get article background

THE debate about the long-term ecological risks associated with genetically modified (GM) crops took an unusual turn this week. Amid the acrimony, somebody actually published some data. Mick Crawley and his colleagues at Imperial College London have written up in *Nature* the results of their decade-long investigation into the competitive abilities of a number of strains of GM plant. They found that, far from marching like weeds over the countryside around their planting sites, the crops in question tended to curl up and die in the face of competition from wild species.

The team's study began in 1990. At that time only four crop species—rape, maize, sugar beet and potatoes—had been subjected to genetic modification with a view to commercial planting. The rape, maize and beet had been modified with genes intended to promote immunity to herbicides. The potatoes were modified to resist the attentions of plant-eating insects. One type had an insecticidal gene from a bacterium called *Bacillus thuringiensis* engineered into it. The other contained a pea gene for the production of a poison called lectin.

The team tested all five of these strains by planting them in plots mixed with versions of the same species that had been produced by traditional breeding methods—and thus did not contain any "foreign" genes. The tests were carried out in three different sites in Britain (Cornwall in the south-west of the country, Berkshire in the south and Sutherland in the far north), and in three successive years, in order to reduce the effects of varying habitats and of different weather conditions in different years.

The tests showed that, when untended by people, all four species of crop did badly. Of the 48 plots planted, 47 went extinct within four years. The exception, a plot of potatoes, lasted the whole decade. But, more significantly, the genetically modified varieties tended to do worse than those produced by traditional methods of plant breeding. The surviving potatoes, for example, were all of the traditional sort.

That crop plants do badly in competition with wild species is to be expected. The protection they receive from farmers is, in evolutionary terms, a *quid pro quo* for the fact that their physiologies are modified to serve human ends, rather than being sharpened for the cut and thrust of life in the wild. But it is odd, at first sight, that genetic modification in a laboratory should weaken a plant any more than traditional breeding methods do.

Natural selection, however, is very demanding. It will embarrass genes that are even slightly malign. And traditionally bred varieties have undergone a process more akin to natural selection than those which

have merely had genes from other species inserted into them. In these cases, selection is probably acting on the cost in materials and energy of making the products of the introduced genes (in other words, the protein that bypasses the herbicide, or the poison that protects against the insect).

Obviously, herbicide resistance is something that is useful only when there are herbicides around to resist. Otherwise, it is just a cost that has to be borne. Insect resistance, however, might be expected to be as much of an advantage in the rough and tumble of the wild as in the cosseted environment of the farmer's field. Not necessarily, says Dr Crawley. Previous studies of wild-plant ecology have shown that the main threat to a plant's existence comes not from insect predators but from competition with other plants.

Herbivorous insects are, of course, a big problem for crops. Indeed, they can reach plague proportions, as in the case of locusts. But that only happens because the crops in question, being laid out in fields like a banquet, form an abundant source of food. In the wild, where individuals of a species are dotted around and have to be sought out by their predators, having a few leaves nibbled away is a minor nuisance compared with having your root system strangled and poisoned by your neighbours.

Needless to say, Dr Crawley's result does not imply that genetic modification of crops is environmentally safe in all circumstances. The varieties he was planting were the first, tentative products of commercial genetic engineering. Today's gene technologists are much more ambitious. They hope, for example, to produce drought-resistant and cold-resistant plants, in order to extend the range over which they can be planted. But even these species will still be crops, and thus designed both to be tended by humans and to serve human ends. Any crop, no matter how robust, is necessarily symbiotic with people. Take away its human symbiont and it is unlikely to do well by itself.

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Eros

NEARer to thee

Feb 8th 2001
From The Economist print edition

DESPITE its name, Eros is no more romantic than any other huge rock. It measures about 33km (21 miles) long and 13km wide, and is pockmarked with craters from the collisions it has suffered during its 4.5 billion years of existence. It is also several hundred million kilometres from earth, so discovering even this basic information cost $223m and took four years. That, however, is a comparatively small price as space missions go. The spacecraft that made the journey, called NEAR–Shoemaker (the "NEAR" is short for Near Earth Asteroid Rendezvous; the "Shoemaker" was added later in tribute to a dead astronomer), was the first probe to be launched as part of NASA's "Discovery" programme. This programme is supposed to epitomise the agency's then-new mantra of "faster, better, cheaper".

AP

Target practice

NEAR has been orbiting Eros since last February. In that time it has measured most of the asteroid's vital statistics, including its shape, chemistry, gravitational field and density. It has scrutinised its topography, sending back images of craters and ridges on the surface, answering some questions about these and raising many more. It has illuminated the link between asteroids and meteorites, adding to understanding of the creation of the solar system. Indeed, it has relayed ten times as much data to earth as its creators at the Applied Physics Laboratory of Johns Hopkins University in Maryland had originally hoped for. And on February 12th, as their grand finale, the researchers hope to crash-land it on the asteroid's surface.

In some ways Eros is an unconventional object. Most asteroids patrol the space between the orbits of Mars and Jupiter. Eros, as the mission's name suggests, goes round the sun in an orbit that brings it much closer to earth. Its composition, however, has turned out to be boringly normal. In fact, it has much in common with many of the meteorites that land on earth. These meteorites, known as "ordinary chondrites", have long been suspected of coming from the asteroid belt, since sunlight reflected from many asteroids there looks a lot like sunlight reflected from a chondrite. But NEAR's close-up probing has confirmed the similarity with only a few remaining doubts (Eros lacks, for example, the abundance of sulphur of most ordinary chondrites).

The most useful aspect of this similarity is that it confirms the value of studying meteorites. Since most objects in the asteroid belt are primitive, dating back to the beginnings of the solar system, the information they hold—their chemistry, and the temperature and pressure under which they were created—can be used to understand what conditions were like when the planets formed. NEARclosesinglequote>s results mean that researchers can continue to study meteorites in the comfort of their own laboratories, confident that they can apply the results to the theory of planetary formation.

One difference between Eros and ordinary meteorites, however, is that the asteroid is not magnetic. This came as a surprise to Andrew Cheng, the programme's head scientist at Johns Hopkins. Most of the meteorites that land on earth are magnetic. Early lodestones, for instance, were almost always made of meteoritic fragments. Scientists had generally believed that these were magnetised because they had broken away from magnetic asteroids.

NEAR has also revealed much about the asteroid's structure. Before the probe was launched, astronomers did not know whether asteroids were solid objects or collections of smaller pieces of rock, referred to in the trade as rubble piles. During its time in space, however, NEAR confirmed the existence of both types. Mathilda, an object that NEAR passed briefly on its way to Eros, turned out to be a rubble

pile. Eros is solid.

Landing the spacecraft is the last step of the NEAR mission, and something not included in the team's original plans. The opportunity, however, proved irresistible. It affords Dr Cheng and his colleagues the chance to get an even closer view of Eros's craters. These have proved puzzling because they appear to have filled up with dust. Since Eros's gravity is so small (a person on its surface would weigh only a few dozen grams), this dust probably could not have fallen into the craters in the way that it would on a heavier body. But there is a catch: NEAR was not designed to land. Instead, it must be crashed on to the asteroid's surface.

The crash, which NASA refers to as a "controlled landing", will attempt to bring NEAR down to Eros at a rate of between 5 and 7 kilometres per hour—about walking pace. The craft itself may not survive this, but it gives the project's engineers a chance to practise landing a spacecraft remotely on a relatively small target with a gravitational field that varies immensely from one place to another. That will be valuable information for engineers controlling the Muses-C mission, a joint venture between NASA and the Institute of Space and Aeronautical Science in Japan. This mission, which is due to blast off in 2002, will send a spacecraft to an asteroid to collect surface samples, then return them to earth for analysis.

Because of its shape and the location of its instruments, even if NEAR lands precisely where and how it is supposed to, it will be unable to transmit images from Eros's surface. However, even if nothing comes from this final, kamikaze journey, the project has already proved to be a success. According to Edward Weiler, one of the heads of space science at NASA, NEAR-Shoemaker is proof that "faster, better, cheaper" is an approach that can work, if applied intelligently and not taken too far. Some claim the chances for a clean landing are about 1%. Dr Cheng is more optimistic, believing that the encounter will be anything but a NEAR miss.

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Gaining the upper hand

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From The Economist print edition

WHAT gave modern people their edge, and enabled them to displace the other human species, such as Neanderthals, who once shared the earth with them, is a matter of lively debate. Superior mental faculties, such as language and the ability to engage in abstract problem solving, are the sort of explanations that are currently all the rage. But Wesley Niewoehner of the University of New Mexico has unearthed evidence that harks back to an earlier idea. This is that *Homo sapiens* became sole ruler of the planet because he was better at manipulating tools.

“Unearthed”, in this case, is literally the truth. Dr Niewoehner’s evidence, published in the current edition of the *Proceedings of the National Academy of Science*, comes from fossils dug up in the Middle East. These fossils, which date back some 100,000 years, come from two sites in Israel, called Skhul and Qafzeh. The Skhul and Qafzeh skeletons are not identical with those of modern people but are clearly distinguishable from those of Neanderthals, and are generally classified as an early form of *Homo sapiens*. Dr Niewoehner was interested in whether this resemblance extended as far as the way they used their tools.

It has been known for some time that the grip of *Homo neanderthalis* was different from, and in some ways inferior to, that of *Homo sapiens*. In particular, Neanderthals wielded their tools in a so-called power grip—held in the palm of the hand with the fingers curled around the body of the tool. By contrast, modern people make extensive use of tools with hafts and shafts, such as hammers. That provides mechanical advantage, and thus more force.

What is not so clear is when this distinction first occurred. To see if it stretches back as far as 100,000 years, Dr Niewoehner compared skeletal hands unearthed at Skhul and Qafzeh with those of Neanderthals, and also with more recent *Homo sapiens*, ranging in age from about 40,000 years ago to the mid-20th century.

His analysis focused on the joints between the carpal and metacarpal bones of the wrist and hand. The orientations and shapes of these joints are a good indication of what movements the hand in question can make comfortably, and how much force it can exert in particular directions.

To compare his samples, he produced three-dimensional computer models of them. He photographed each facet of the carpometacarpal joint from several directions, and fed the results into a program that produced a 3D grid of the surface in question. The computer then compared these grids to see which of the reference samples (Neanderthal, or the various forms of modern human) the Skhul and Qafzeh bones most resembled.

Almost without exception, the answer was that they resembled a modern human, rather than a Neanderthal. In particular, they proved to be well adapted to the use of tools with hafts and shafts. Even at that early stage, it seems that humanity’s ancestors were shafting the opposition.

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Vertigo

A new kind of pacemaker

Feb 8th 2001
From The Economist print edition

SOME people really do think that the world revolves around them—but they deserve sympathy, not reproach. They are suffering from the plight known as vertigo, a nauseating affliction of the brain's sense of balance that produces a sensation of continuous spinning. While many people feel this way sometimes, and pilots and deep-sea divers do so quite often, vertigo patients have to cope with such disorientation nearly all the time. Erik Viirre, of the University of California, San Diego, thinks he may have found a way to bring sufferers some relief.

Vertigo is the result of damage to the body's balancing mechanism. This mechanism is called the vestibular system, because it is wired into the inner passage, or "vestibule", of the ear. But it is also linked to the sense of sight through the vestibular-ocular reflex (VOR). This means that when nerves in the ear sense that the head is moving one way, they tell the eyes to move the opposite way to compensate. Sufferers of vertigo have a slow VOR. That causes their gaze to slide along with the movement of their heads, leaving them confused and nauseated.

If only the world moved more slowly, these patients could keep their bearings, even with their sluggish VORs. And for brief periods, at least, Dr Viirre has found a way to put the brakes on, through the use of virtual-reality technology.

When wearing a pair of goggles fitted with small video screens, one of Dr Viirre's subjects has the impression of standing within a computer-generated panorama, which can be examined in any direction in real time. Or, for that matter, in not-so real time: by adjusting the computer, Dr Viirre or one of his collaborators can control not only what the subject sees, but how fast he perceives it.

In the real world, the farther away an object is, the slower it seems to move. (That is why the horizon appears motionless, and is reassuring to look at during a bout of seasickness.) This means that shrinking a virtual scene, which makes it look farther away, also makes it appear to move more slowly. Dr Viirre is using this illusion to train those with a slow VOR into faster performance.

To do so, he follows an old rule of thumb used by mothers and psychologists to get people to change their behaviour. This rule is that a bad habit, or a bad reflex, cannot be undone all at once. It requires gradual coaxing. So he starts by measuring the speed at which his subjects, vertigo patients all, actually register motion. Then, he sets his virtual environment to run just a little faster than that comfort level. If, for instance, the speed of a subject's VOR means that he registers motion at half-speed, Dr Viirre shrinks the size of the virtual scene by only 45%. That still keeps things moving at a slightly discomfiting clip for the patient, even though the pace is much slower than in the real world.

While standing in this decelerated scene, the patient is asked to carry out tasks that require him to search the virtual environment: looking for all the "people" wearing red shirts, say, or blue ties. Every five minutes, the task is made more difficult by speeding the scene up another 3-5%. At the end of each 30-minute session, the subject's VOR is measured again, and at the next session, the initial speed of the display is set slightly higher than this new benchmark. The control subjects, who are also vertigo sufferers, perform all ten sessions, but are shown scenes that unfold at normal speed.

Dr Viirre's hope was that his test subjects' VORs would speed up enough to adapt to these changes, and that the adaptation would continue even when the goggles were off. The preliminary results are encouraging, as he reported this week at a conference of the Association for Research in Otolaryngology (as the field is known) in St Petersburg Beach, Florida. The nine subjects in his preliminary study showed an average increase of 16% in their VOR speed after the sessions. And one week after the sessions ended, some of that improvement persisted. The half-dozen controls, by contrast, showed no improvement—and in some cases may even have become a bit slower.

Once Dr Viirre refines his training regime, he hopes to see larger and more permanent effects. If the project is a success, other patients will benefit from a surprising application of a comparatively new technology. The technology benefits, too. At the moment virtual reality has a rather lightweight reputation, and has not really made its mark outside the entertainment industry. By helping to rehabilitate vertigo sufferers, it will have shown that it is good for something other than playing games.

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Microsoft v Microsoft

Feb 8th 2001
From The Economist print edition

Two new books about the Microsoft trial offer distinct but complementary accounts of a landmark case

WORLD WAR 3.0: MICROSOFT AND ITS ENEMIES
By Ken Auletta

Random House; 456 pages; $27.95.
Profile Books; £17.99.

Buy it at
Amazon.com
Amazon.co.uk

PRIDE BEFORE THE FALL: THE TRIALS OF BILL GATES AND THE END OF THE MICROSOFT ERA
By John Heilemann

HarperCollins; 246 pages; $25 and £16.99

Buy it at
Amazon.com
Amazon.co.uk

Get article background

ON PAPER at least, the trial of Microsoft for antitrust violations has all the makings of a terrific courtroom drama: on the cusp of the biggest economic boom most of us can remember, the world's largest company is sued by the world's most powerful government. Mountains of incriminating evidence reveal the business practices of its secretive and controversial boss, the richest man on earth. It ought to be edge-of-the-seat stuff, with sudden courtroom twists, smoking guns (or e-mails) and high-level corporate betrayals. Unfortunately, the rare moments of excitement in the trial were lost in grinding legal argument about consent decrees, application-programme interfaces and middleware. Making that sound dramatic is a challenge.

Of more immediate interest was how the trial illuminated the gap between Microsoft's ruthless tactics and its wish to present itself as an innovative and benevolent enterprise, interested in bettering its customers' lives. Microsoft goes to great lengths to manipulate its public image, using countless press officers to spin and counter-spin every announcement made by the firm or its rivals. Press coverage of the company is monitored with an almost narcissistic zeal: press clippings pasted into scrapbooks used to be distributed on Microsoft's campus, so that employees could see what was being written about the company, though e-mail is now the preferred method of distribution. Microsoft maintains profiles of individual journalists, and their perceived interests and biases; it grants access to favoured reporters, but snubs those it deems too critical of the company. All of which means that getting a clear picture of Microsoft is extremely difficult.

The trial, however, provided a way to by-pass the company's spin doctors as internal e-mails between

senior executives could be matched against Microsoft's public statements. It was the resulting fragmentary insight into the software Goliath that saw itself as David, rather than the day-to-day jousting of the lawyers, that was the most fascinating aspect of the case.

Even so, in "World War 3.0", Ken Auletta, a writer at the *New Yorker*, opts for the stage format of courtroom conflict. After setting the industrial scene, he introduces the main characters and describes each witness. Detailed character sketches and explanations of the issues are interwoven, though not always seamlessly. And Mr Auletta's efforts to animate the story with the help of elevated prose and the kind of military metaphors beloved of business magazines serve mainly to underline how dull most of the raw material of the trial actually was. (The judge hearing the case, Thomas Penfield Jackson, fell asleep on several occasions.)

David Boies, the government's lawyer, drew some blood in his cross-examinations, but by and large both sides kept to their scripts; there was no knockout punch that sealed the outcome of the trial. What little tension there was came from Mr Boies's shrewd and devastating use of the videotaped deposition of Microsoft's boss, Bill Gates, who came across as evasive, forgetful and generally untrustworthy.

But although the trial itself failed to excite, Mr Auletta has an ace up his sleeve: his interviews with Judge Jackson, which are unquestionably the highlight of his book. We are told that Judge Jackson regarded Mr Gates as an arrogant, Napoleon-like figure, that he admired Mr Boies as the finest lawyer ever to have appeared in his courtroom and that he thought Microsoft's lawyers made several serious errors. After Judge Jackson issued his ruling, Microsoft's lawyers complained that he was biased and have cited Mr Auletta's book as evidence.

Mr Auletta also gained behind-the-scenes access to the failed mediation effort led by Judge Richard Posner, and reveals how close Microsoft came to settling the case at the last minute. The company was, he explains, prepared to make several concessions it had previously rejected outright. But Judge Posner's mediation did not bear fruit, in large part because of his failure to involve the representatives of the 19 states that sued Microsoft alongside the government.

When the grassroots sue

John Heilemann's book tells the same story from a different perspective. Whereas Mr Auletta gives a top-down view, placing the Microsoft trial in the broader context of the telecommunications, technology and media industries, Mr Heilemann, a former writer for this newspaper, gives the bottom-up view from Silicon Valley, where, he argues, a handful of maverick individuals were instrumental in getting the government to bring its case against Microsoft.

Mr Heilemann reveals the existence of Project Sherman, a $3m initiative funded by Microsoft's arch-rival, Sun Microsystems, which paid dozens of lawyers and antitrust experts huge fees to amass the evidence to help persuade the United States government to take Microsoft to court. Mr Heilemann's Silicon Valley connections provide him with a number of illuminating and colourful anecdotes about the trial, and the motivations of those involved in it. He even unearths an eyewitness to the crucial meeting in 1995 between Microsoft and Netscape, at which, he confirms, a Microsoft official threatened to "cut off Netscape's air supply".

"Pride Before the Fall", much of which appeared as a long article in *Wired*, is thankfully sparing in its account of the trial itself. Unlike Mr Auletta, Mr Heilemann knows how to explain technicalities in easy language, so that his book is less laden with forbidding jargon. And while Mr Auletta's descriptions of his face-to-face encounters with Mr Gates are self-aggrandising, Mr Heilemann's are not.

Anyone looking for the behind-the-scenes story of the Microsoft trial will have to read both books to get the full picture. Mr Heilemann's account is the more entertaining and faster-paced of the two, whereas Mr Auletta's is more substantial. What both have in common is their portrayal of Microsoft officials as arrogant, foolish and politically naive in expecting to be able to best the American government in the same way that they crushed so many of their competitors. In the end, the judge ruled that Microsoft had acted illegally, using anti-competitive measures to preserve its monopoly and by being predatory towards its competitors. Whatever happens next—the case goes to the appeal court later this month—it is clear that Microsoft should have settled the case years ago, when it had the chance. Ultimately, Microsoft's worst enemy proved to be neither the Department of Justice, nor its rivals in Silicon Valley, but itself.

TOM STANDAGE

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“Antitrust”: the movie

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The man on the right is not Bill Gates but Tim Robbins, who looks and acts like the software mogul in a new film, “Antitrust”. Apart from William Randolph Hearst (“Citizen Kane”), few American tycoons have stood out as distinct enough personalities to inspire Hollywood. So it is flattering to Mr Gates that MGM should have made a recognisable villain of him in a thriller pitting an open-source hero (Ryan Philippe, left) against a computer tyrant. The film, which is not doing well at the box-office, did not worry Microsoft, which professed to believe it was about AOL or Oracle.

AP

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Economics in history

Not the whole story

Feb 8th 2001
From The Economist print edition

IN AN essay of this historical sweep, it is always good to have something to shoot at. “The Cash Nexus” provides Niall Ferguson, a prolific Oxford historian, with not one target but several. With practised eye, he takes aim at the claim that economics decides the course of history; that democracy brings wealth and peace; that Britain and America were undone by imperial overstretch; and that today’s world is governed by financial markets. Each of these large claims is shot down with elegance and skill, backed up by wide erudition.

THE CASH NEXUS: MONEY AND POWER IN THE MODERN WORLD 1700-2000
By Niall Ferguson

Basic Books; 560 pages; $30.
Penguin; £20

Buy it at
Amazon.com
Amazon.co.uk

The roots of Mr Ferguson’s latest work can be detected in his history of the house of Rothschild (1998), though its immediate genesis, as he tells us, was in a planned history of the world’s bond markets. Having embarked on that, however, he was diverted into a general attack on economic determinism, which constitutes this new book’s main thread.

He sets out, promisingly enough, to explain how the demands of war and the struggle for power led 18th-century Britain to foster such institutions as a tax-gathering bureaucracy, parliamentary government, a public debt market and a central bank. The obvious contrast is with Britain’s bigger and richer rival, France, which lacked the right institutional and financial framework to win their innumerable wars.

As Mr Ferguson points out, for most of the century France had a smaller national debt than Britain—but, crucially, it paid three times as much in debt service, thanks partly to its long history of defaults. Britain’s eventual triumph was not, therefore, a matter of sheer economic muscle. Bishop Berkeley’s famous observation, that credit was “the principal advantage that England hath over France”, pointed rather to a sounder institutional framework. This episode is wisely offered as a lesson for other countries, even today.

After this strong beginning, however, the book wanders off into the rising demands of the welfare state; the myth that in modern democracies economic success assures electoral success; and the corrupting influence of money on contemporary politics. There is even a foray into the role of gold, Keynes’s “barbarous relic”, to which are added some rather hurried (and mostly negative) comments about the prospects for Europe’s economic and monetary union. The book closes with a plea for more immigration to western countries (and more defence spending by them). There is a valiant attempt at a conclusion which gives economics and finance their due, while allowing that sex, violence and the pursuit of power often overwhelm them. By this point, the thread is as good as broken.

None of this is to deny the pleasures and rewards that will be got from “The Cash Nexus” by professional historians and general readers alike. Mr Ferguson’s scholarship is lightly worn, and his range of reference wide: from Carlyle (who supplied the title), through Wagner and sundry philosophers to such 19th-century novelists as Tolstoy, Trollope and Zola. Almost every chapter has its own delights. But it is hard to escape the overall conclusion that, after producing so many fine books so quickly, Mr Ferguson might have done better to have worked out a more coherent and convincing thesis.

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Culture and the humanities

Both ways

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ACADEMIC INSTINCTS
By Marjorie Garber

Princeton University Press; 187 pages; $19.95 and £11.95

Buy it at
Amazon.com
Amazon.co.uk

THE dust-jacket of this book reproduces a detail from Raphael's "The School of Athens", in which the great thinkers of the ancient world are anachronistically assembled as though for one great toga-wearing seminar (Marjorie Garber discusses the picture as emblematic of the yearning to cross disciplinary as well as chronological boundaries). In the foreground of the original, Diogenes the Cynic lounges on the steps, leaving a space between himself and the more loftily discoursing Plato and Aristotle. Into this space a digitally enhanced photo of Ms Garber and her two golden retrievers has been deftly inserted. Anyone who thinks the academic world is going to the dogs should read this book—though if you are at all allergic to chutzpah, the jacket should serve as the equivalent to the warning that a product may contain nuts.

Teacher's pets among the big baguettes

Ms Garber is the queen of crossover. "Crossover", in case you haven't heard, refers to the way in which certain individuals or books manage to combine serious academic standing with wider non-academic popularity. Ms Garber is a professor of English at Harvard, but she clearly hasn't let that slow her down. She's also written bestselling books on real estate, cross-dressing, and loving one's dog. Now, in this seductively slim, witty volume, she sets about justifying the ways of dons to man—not, of course, that she uses archaic terms like "dons" or "man".

Each of the book's three chapters addresses an issue that constantly recurs in debates about the humanities: the question of whether the "amateur" has been wholly displaced by the "professional"; the ideal of disciplinary purity and the suspect status of new disciplines; and the ever-recurring complaint about the use of "jargon" by academics. In all three cases, Ms Garber's strategy is the same: drawing upon a wide range of scholarly and journalistic sources, she shows that the terms of each of these debates are unstable—what is praised as "plain language" at one moment is derided as "jargon" the next—and that in fact this instability is a necessary feature of the intellectual vitality of work in the humanities. Today's professionals are tomorrow's amateurs, all disciplines are hybrid and constantly evolving, the charge of "jargon" simultaneously registers disturbing novelty and jaded familiarity. The book is, in effect, an elegant demonstration of the nature of dialectical thinking as applied to some of the hot topics of the recent "culture wars".

Ms Garber says more than once that the point is not to "take sides" in the heated, wearying disputes about these issues, but to understand the function of the disputes themselves. However, her book does take sides, despite her disclaimers. To say, for example, that current complaints about jargon are part of a pattern in which the critics misunderstand the nature of linguistic innovation is to say that the objection is misconceived: it is to try to deprive the critics of their weapons. Although she adopts a fashionably relativist tone, in which the "dissolving" of boundaries appears as the highest good, Ms Garber is laying down the law. By presenting as positive and necessary those features of contemporary literary theory and cultural studies that are so widely deplored, she is implicitly defending those practices against their

(largely non-academic) detractors.

While by no means all such complainants are well-motivated or well-informed, lay readers may feel that here is a case of the professor who wants to have it both ways. Her prose in the main text is colloquial and unintimidating, while heavily armoured units gather in the footnotes in the form of quotations from Adorno, Barthes and company. On this showing, the cocktail of the day is Literary Theory Lite. It slips down very pleasantly, inducing a benign feeling in which all previously troubling issues lose their urgency and sharpness. Jargon, schmargon—and aren't they just the cutest dogs?

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Giving the finger

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GESTURE IN NAPLES AND GESTURE IN CLASSICAL ANTIQUITY
By Andrea de Jorio. Translated by Adam Kendon

Indiana University Press; 632 pages; $49.95 and £34

Buy it at
Amazon.com
Amazon.co.uk

A MAN and a woman are talking on a bus in Naples. All of a sudden, the man raises his hand, draws together his fingertips, lifts them to his lips and appears either to spit on them or to give them a kiss before pointing them at the woman. How to know whether his intentions are noble or base, romantic or murderous—spitting on one's fingertips being the second most deadly insult in Naples after spitting directly in your face?

The answer may well be found in Andrea de Jorio's extraordinary volume, "Gesture in Naples and Gesture in Classical Antiquity", now finally translated into English almost 170 years after it was first published. Born in 1769, de Jorio was a cleric and a canon of the cathedral of Naples who asked to be released from his godly duties when he discovered a richly decorated ancient Greek tomb near Cuma and fell passionately in love with archaeology. De Jorio believed that ordinary Neapolitans had preserved in their culture many of the traditions that came down from the ancient Greek founders of the city. A proper study of contemporary facial and bodily gestures, he believed, would help interpret the figures that were coming to light in the excavations being undertaken at Herculaneum, Pozzuoli and Pompeii in the first half of the 19th century.

1. Mano in fica (sexual insult)
2. Danaro (money)
3 & 4. Stupido (stupid)
5. Amore (love)
6. Chiedere (asking)
7. Condotta versipelle (deceitful conduct)
8. Schiopetto (finger-snap)
9 & 10. Disprezzo (scorn)

"Gesture in Naples" was, its American publishers claim, the first book ever to make a proper ethnographic study of gesture. With commendable—and occasionally pedantic—care, de Jorio lists and describes all the Neapolitans' expressions for love, lust, teasing, cuckoldry, rage, scorn, disappointment and disdain, together with their myriad interpretations. The association with antiquity is perhaps less interesting to a modern reader than the study of gesture as communication. As a chronicle of the salty doings of a richly theatrical city, "Gesture in Naples" is unsurpassed; as a snapshot of a society now homogenised like any other, it is unique.

In modern times, Luigi Barzini was the writer who did most to put out the word on de Jorio and his classic. In "The Italians" (1964), Barzini described "Gesture in Naples" as a gem, though one so difficult to obtain that he had to resort to purloining a copy from an unsuspecting English gentleman. Thanks to a fine translation by Adam Kendon, an anthropologist who has studied aboriginal sign language—and to the imagination of Indiana University Press—thefts of this kind will no longer be needed.

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Japan observed

Concretely

Feb 8th 2001
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DOGS AND DEMONS: TALES FROM THE DARK SIDE OF JAPAN
By Alex Kerr

Hill and Wang; 448 pages; $27

Buy it at
Amazon.com
Amazon.co.uk

THIS is a gloomy book, made darker by the author's disillusionment with a Japan that failed to live up to his expectations. Like so many before him and since, the young Japanologist fresh out of college in America in the early 1970s was drawn to the country by its artistic treasures, a love of the language and visions of "lush mountains and clear-running streams pouring over emerald rocks". But, again, like so many foreigners who have adopted Japan and made it their home, affection eventually turns to frustration, anger even, as the subtle and inevitable exclusion by a culture that treasures its homogeneity starts to erode the foreigner's enthusiasm.

The book opens well enough. Anyone who has spent more than a week travelling around Japan quickly realises that the country is one big construction site. Mr Kerr vents much of his spleen on this concrete vandalism of the countryside and explains graphically why the archipelago has been seemingly paved from tip to toe. Apart from being the biggest employer in Japan, putting the rice on the table in one out of every six households, the construction industry is by far the largest contributor to the ruling Liberal Democratic Party. Having built all the roads, bridges, tunnels, harbours, airports, schools, hospitals and city halls that the country is ever likely to need, so desperate have the construction companies become to find new places to pour their concrete that they have taken to paving over the river beds and beaches.

The author is rightly scathing about the ugly "tetrapods" that barricade much of the Japanese coast. Far from protecting it, studies show that these four-legged, 50-tonne concrete monsters, piled upon one another along the beaches, actually hasten erosion. But making them, and manhandling them into place, is big business. Japan spends twice as much (as a percentage of gross domestic product) on public works as America. The irony is that it was America which, under its Structural Impediment Initiative of the late 1980s, bullied Japan into doubling its commitment to public works—in a misguided attempt to divert it from allocating so much to its export industries.

In the end, however, the book creates a misleading impression by implying that life for the average Japanese was somehow more harmonious and fulfilling in earlier times, and that in important respects it has been downhill ever since. For the majority of Japanese, the norm for centuries was grinding poverty, disease and incipient malnutrition until the post-war reconstruction, kick-started by the allied occupation, began to work its magic. The life expectancy for the average Japanese by the end of the second world war was 47 years—about the same as it had been a century earlier. Now it is around 75 years. If truth be told, today is Japan's golden age, despite being still mired in post-bubble detritus, plagued by political ineptitude and set more than ever in concrete.

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Cancer research

The good doctor

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SCIENCE, like the church, has its share of heretics—those who question current thinking or dare to propose a different view. It also has ways of dealing with such dissenters, deriding their arguments, denying their research funding or declining to publish their findings. Those who challenge the scientific orthodoxy are more often cold-shouldered than burnt at the stake. But a few, armed with proof and persistence, survive the deep freeze to see their ideas take hold. One of these is Judah Folkman, a surgeon-scientist at Harvard University, whose notions of how the body builds blood vessels have travelled from the fringe of medicine to the front-line of cancer therapy.

DR FOLKMAN'S WAR: ANGIOGENESIS AND THE STRUGGLE TO DEFEAT CANCER
By Robert Cooke

Random House; 320 pages; $25.95

Buy it at
Amazon.com
Amazon.co.uk

About 40 years ago, Dr Folkman noticed that tumours cultivated in lab animals will stop growing without a network of blood vessels running through them. Others had observed this phenomenon before, only to dismiss it as unimportant. But the blood vessels struck Dr Folkman as more than an anatomical curiosity: surely here lay the key to a tumour's survival, providing it with the oxygen and nutrients needed for growth. Dr Folkman reckoned that this vascular lifeline was so critical that cancer cells must produce a biochemical to encourage such "angiogenesis"—the process by which the body creates new blood vessels branching off the existing circulatory system, rather like laying new pipe from the water mains. Moreover, he speculated that once this biochemical was isolated, it could be used to encourage blood vessel formation in bits of the body that need it, such as healing wounds, and that other substances might exist to block it where it was causing more harm than good, as in tumours.

But Dr Folkman faced two hurdles in testing his theories. The first was technical: before the mid-1980s, when molecular biology and the easy manipulation of DNA started to make mass production of complex biochemicals easy, extracting trace molecules from the body required mountains of tissue and months of complex chemistry to obtain a few specks of the desired substance. The second, and more daunting, was cultural: the hostility of a research establishment wedded to the notion that cancer should be fought with surgery, radiation and chemotherapy, rather than by fiddling around with a tumour's plumbing, and highly resentful of an ace surgeon who also dared to do basic research.

Dr Folkman has fought his struggle during a period of remarkable upheaval in medicine. When he began, it was unusual for academics to strike alliances with the pharmaceutical industry. Dr Folkman was among the first to reach out to firms like Monsanto for help. Nowadays partnerships of this kind are commonplace, universities are patenting madly and researchers are starting biotech firms by the score. Public curiosity about medicine has also grown and, with it, the space given to medical research by the media. In 1998 Dr Folkman learned this the hard way, when an over-enthusiastic article in the *New York Times* trumpeted an imminent cure for cancer. To his embarrassment, the article set off an international storm and sent shares in EntreMed, the company making his molecules, soaring.

Dr Folkman's war is far from won, but he has scored some notable victories. Several of the anti-angiogenic substances identified by his team, among them endostatin and angiostatin, have been shown to slow tumour growth and are now being put through their paces in clinical trials. In the process, Dr Folkman has gained a formidable scientific reputation as well as respect for his clinical prowess and generous nature. It is a rare combination, which this book describes at times in almost hagiographic tones. Dr Folkman's own assessment is blunter: "You can tell a leader by counting the number of arrows in his ass."

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Not a girl's best friend

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"IT'S a bonny thing," says Sherlock Holmes, in "The Adventure of the Blue Carbuncle", as he admires the jewel of the story's title. "Just see how it glints and sparkles. Of course it is a nucleus and focus of crime. Every good stone is. They are the devil's pet baits. In the larger and older jewels every facet may stand for a bloody deed." Tobias Hill quotes these lines in "The Love of Stones", and one wonders whether they gave him the hint for his novel, for it too is a detective story of glinting and sparkling jewels that inspire bloody deeds.

THE LOVE OF STONES
By Tobias Hill

Faber and Faber; 397 pages; £10.99

Buy it at
Amazon.co.uk

The novel opens with the brutal murder of John the Fearless, the second Valois Duke of Burgundy. The unfortunate duke dies in fine style, however, sporting a magnificent shoulder knot comprising three rubies and three pearls with a huge diamond in the middle. This splendid piece becomes known as the Three Brethren.

Meanwhile, in the contemporary present, a young English woman, Katharine Sterne, has become obsessed with the long-lost Three Brethren and resolves to track it down. The narrative sweeps from the battlefields of 15th-century France to the gaslit streets of a grubby, Dickensian London to the teeming marketplaces of modern Turkey. Interwoven with all this is a further tale, that of two Iraqi brothers, Daniel and Salman, who come to London in the early 19th century, hoping to make their fortune as jewellers.

Though full of incident and historical detail, "The Love of Stones" fails to deliver on other levels. Its central character, Katharine, never comes to life off the page, and the question "Why is she doing this?" is not satisfactorily answered. She speaks of "the soulless lives of stones"—an unprepossessing quality which she shares. Not caring about Katharine as a character makes it difficult to care about her quest and all that it involves. One admires the novel's scope and ambition, but longs for a little more humanity and warmth.

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Contemporary music

The inclusive Mr Adams

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A new work from America's most-performed composer should be heard and not seen

IN THE best traditions of American democracy, John Adams is a passionately inclusive composer. Throughout his career, he has resisted attempts to segregate high and low culture, popular and classical music. This breadth was part of his birthright: his father was a big-band clarinettist, his mother a ballroom singer, and they both loved the music of the classical masters. As Mr Adams himself once put it, "I grew up in a house where Benny Goodman and Mozart were not separated."

At university in the 1960s he encountered a different attitude. Academic music was dominated by serialism, which stressed formal structures over frank emotion. The streets seethed with rock and social protest, but the restless Mr Adams languished in the Harvard music department, "a mausoleum where we would sit and count tone-rows in Webern. But then we were all going back to our rooms and getting high and listening to John Coltrane and the Rolling Stones."

The budding composer felt the whole experience was schizoid and dishonest, and he fled to San Francisco, where he has lived ever since. His musical turning point was the discovery of the minimalist school of composition, which combined fizzing pulsation, mesmerising patterns and engaging tunes. Mr Adams quickly developed his own voice, going beyond minimalism and gleefully incorporating whatever bits of idiom he wished, from Beethoven and Mahler to swooning mock-Hollywood themes, jazz, rock or gospel. Over the years he has produced original orchestral and chamber works, as well as concertos for violin, clarinet and piano. A survey of top orchestras a few years ago found he was the most frequently performed living American composer.

Perhaps what Mr Adams is best known for are his operas—surprisingly, since initially he was not attracted to this most select and elevated of musical forms. However, his mind was changed when he met a path-breaking young director, Peter Sellars, who proposed the historic meeting of Richard Nixon and Mao Zedong in 1972 as a subject. Premiered in 1987, "Nixon in China" was an instant hit, from its sensational opening depiction of the president's jet touching down in Beijing, through state functions and walkabouts to the solitary musings at the end.

This new "docu-op" was notable both for the range of Mr Adams's music and Mr Sellars's ingenious, indeed occasionally overwhelming staging: the director was clearly as much a part of the production as the composer. But in their second opera, "The Death of Klinghoffer" (1991), Mr Sellars seemed to take a worrying precedence, creating a hyperactive melange which actually obscured the narrative and swamped the music. Though Mr Adams finds Mr Sellars's creative energy inspiring, and shares his desire to expand music theatre's range of reference, the director's excesses seem to loom again in their latest collaboration, "El Niño", an oratorio which was premiered in Paris before Christmas and performed in San Francisco last month.

The title refers both to the Christian story of the birth of Jesus and to the meteorological phenomenon which has wreaked havoc on the world's weather. Its text comes not just from the Bible but from works by Hispanic authors, especially contemporary women, in an attempt to counterbalance the traditional male point of view. The work is performed by three vocal soloists, chorus, children's chorus, a trio of counter-tenors and three dancers. Though the piece is only "semi-staged"—in an empty space—Mr Sellars has created his usual welter of effects, including entrances, exits, varied groupings and symbolic sequences, in counterpoint to Mr Adams's music.

But his most controversial stroke is a film which runs continuously on a full-size screen above the stage, with its own characters and action. It, too, depicts the story of a birth, to a young Hispanic couple shown in various settings—a beach, a desert, downtown, cruising in a flashy car—and in vague encounters with

other people. There is yet more symbolic action, with dancers and soft-focus new-age images. To many critics the main effect was exasperation—“rubbish”, one called it—an infuriating distraction from what seemed to be a strikingly dramatic score. Mr Adams’s work, they felt, had been reduced to the music-over for an MTV nativity or for a television ad.

In defence of Mr Sellars, one commentator commended the laid-back, “plug in anywhere” aspect of the spectacle. But Mr Adams’s rich, diverse musical world can stand on its own. Indeed he has left himself an escape route for future productions of “El Niño”: as it is an oratorio, not an opera, he can envision the piece as a straightforward concert work in the manner of Handel’s “Messiah”. Many admirers would welcome a chance to hear Mr Adams’s piece, free from the manic inspiration and sensory overload of Mr Sellars. Meanwhile, the breadth of the composer’s achievement from its beginnings can be enjoyed in the 10-CD set, “The John Adams Ear Box”, on Nonesuch 79453-2.

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Renaissance art and architecture

All-round man?

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IN HIS book “The Civilisation of the Renaissance in Italy”, Jacob Burckhardt cited Leon Battista Alberti as a prime example of “universal man”, outstanding for the tremendous range of his interests and abilities, from athletics and horsemanship to art, architecture, archeology and literature. It now seems that Burckhardt’s assessment of Alberti was largely based on a short contemporary account written by Alberti himself. The book tells us much about Alberti’s aspirations and character, but for a more objective assessment of his achievements and historical importance we need to look elsewhere.

LEON BATTISTA ALBERTI: MASTER BUILDER OF THE ITALIAN RENAISSANCE
By Anthony Grafton

Allen Lane, The Penguin Press; £25
Hill & Wang; 432 pages; $35.

Buy it at
Amazon.com
Amazon.co.uk
Amazon.com
Amazon.co.uk

Unfortunately, the records of his life are rather sparse. Born in Genoa in 1404 as an illegitimate member of an exiled Florentine family, Alberti worked from 1431 at the papal court in Rome, though little is known of his official activities there. He is chiefly remembered as an author of numerous books on a wide variety of topics and as a distinguished architect. His writings are not readily accessible to modern readers; even specialists find many of them hard going and often puzzling. Anthony Grafton, an authority on the history of classical scholarship, is ideally qualified to place them in the intellectual context of their time. Yet his claims for their interest and originality are often asserted as a matter of fact rather than convincingly argued.

Mr Grafton devotes most of his attention to the two books by Alberti that are still quite widely read: his treatises on painting and architecture. The first of these, “De Pictura”, written around 1435 in both Latin and Italian, is the earliest work of its kind to have survived. Alberti’s purpose in writing it remains unclear, as does its relation to the painting of the time. Like many academics, Mr Grafton supposes that Renaissance artists felt a sense of intellectual inferiority and would have been grateful to be told what they should be doing by a young papal bureaucrat with a good grounding in the classics, such as Alberti. The evidence for this is less substantial than Mr Grafton implies, and it remains doubtful whether Alberti’s book was widely read or whether it had any significant influence on the practice of painting or on the attitudes of patrons.

Alberti’s treatise on architecture, “De Re Aedificatoria”, a reworking of an ancient text by Vitruvius, was presented to the pope in 1452. It had a relatively wide circulation and may have encouraged Renaissance patrons to take a greater interest in the subject (as well as to employ the author himself). Alberti was probably the first European architect responsible for the design but not the construction of his buildings—in this he was certainly an innovator. More importantly, his educational and intellectual background may well have encouraged him to imitate classical architecture more closely than any of his predecessors or contemporaries, and in this respect his designs were enormously influential. Despite the title of his book, Mr Grafton relegates these designs to a brief and inadequate final section and does not even provide readers with a full set of illustrations.

Burckhardt was both fascinated and repelled by what he took to be the major characteristics of 15th-century Italian society, especially its unfettered individualism and frequent outbursts of violence. Mr Grafton sees it in far more positive and simplistic terms. For him, patrons are always erudite and sophisticated, while the scholars behave rather like the academic stars of the present-day conference circuit, with Alberti himself the biggest star of all. As a result, his book, which reads more like public-relations hype than historical analysis, seems curiously old-fashioned in approach and slightly patronising in tone. Mr Grafton’s portrayal would have been more convincing had he scrutinised his subject with a more critical eye.

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About sponsorship

Gilbert Trigano

Feb 8th 2001
From The Economist print edition

Gilbert Trigano, a founder of Club Med, died on February 3rd, aged 80

EPA

AS OFTEN happens when a project turns out to be as successful as Club Med, there is some disagreement about who should have the credit. Some would give it to Gérard Blitz, a Belgian who in the 1920s and 1930s had won several Olympic medals for swimming and water polo. After the second world war he was running transit camps for Belgian soldiers returning home. He bought tarpaulins and other useful materials from a French factory owned by Gilbert Trigano's family. Gérard suggested to Gilbert (or it may have been the other way round) that, with Europe at peace, they should get into the holiday business. In 1950 they bought some American army surplus tents and camp beds, set them up in a pine wood on the Spanish island of Majorca and called the enterprise Club Méditerranée.

The idea was a success from the start. Holiday camps were not new. In Britain Billy Butlin's camps had provided cheap refuges from often rainy summers. But Club Med offered reliable sunshine and warm seas, along with what Gérard Blitz called "an antidote to civilisation". He saw no need for the holiday "villages" to make money, as long as they covered their costs. What mattered was that people could be liberated from their working lives for a week or two and live as the noble savage, do some cooking if they wanted to and help with the rudimentary washing-up. It was Mr Trigano who turned Club Med into a profitable business. Tents were soon replaced by thatched huts. During Mr Trigano's four decades with Club Med, bungalows and hotels were added with the soft comforts of home. Staff were hired to do the chores. There were Club Med establishments throughout the world, from Tahiti to, ahem, Bulgaria.

Mr Trigano did not discard the romanticism that had made Club Med so appealing when he and his early partner had banged in the tent pegs in Majorca. Rather, he made Club Med's hint of a sensual paradise a key part of its sales appeal. The partly Belgian idea which had been launched in Spain became as French as Bardot. As a loyal Frenchman, Mr Trigano made Club Med a messenger of his country's superiority in food, wine, language and indeed in culture. Then, suddenly, it seemed that paradise was lost.

End of enchantment

After Club Med had showed losses for three successive years in the 1990s, Harvard Business School chillingly used the firm as a study to illustrate "the death of a brand". Club Med had become Club Red because the young people who were once its customers were now middle-aged and less thrilled by its offer of organised, communal living, however comfortable. The next generation saw Club Med as just another big hotel chain.

Gilbert Trigano seemed puzzled quite what to do. Before he became a joint founder of Club Med at the age of 30, he had had little business experience. He had worked briefly in the family firm, done some journalism and tried his hand as an actor. As a Jew in German-occupied France in the war, his chief occupation had been one of survival.

What he brought to Club Med was a seemingly boundless energy. Chain-smoking kept him going on 15-hour working days. His enthusiasm for making Club Med "the laboratory of the modern holiday" was its driving force. He was skilful at getting countries to surrender their finest beaches for new resorts in return for electricity and other infrastructure, and persuading bankers to finance them. He made the brand famous. According to a survey, 78% of Americans had heard of Club Med, and in Europe an astonishing 88%. He brought quality to the much-derided development of "mass tourism".

He was less at ease when asked by his critics about the morality of planting self-contained expensive “pleasure domes” in poor countries where the visitors never ventured out, not even to a local restaurant. When some wanted to see local ceremonies Mr Trigano would bring in actors to stage them. He believed his duty was to protect his *gentils membres* from possible local hostility, but for them it was not quite the same as seeing the country. A guest at even an ordinary local hotel might well feel more of a sense of adventure.

It may be that Mr Trigano eventually became bored with tourism. He was captivated by new developments in technology. Years ago, when computers were still a novelty, he installed them in some of his holiday villages, to the surprise of guests who still believed that Club Med meant the simple life. Mr Trigano claimed, not wholly convincingly, that the distinction between work and leisure was breaking down. He personally rarely took a holiday. He passed his enthusiasm for new technology to François Mitterrand. Back in the 1980s the French president got computers into every school in the country.

After a revolt by shareholders of Club Med in 1997 Mr Trigano and his son Serge, who had become chief executive, stood down from management. Philippe Bourgignon, who had revived Disney’s sickly theme park near Paris, took over, with a promise to return Club Med to health. After all the problems there would be a happy ending. Spoken like a Disney.

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About sponsorship

OUTPUT, DEMAND AND JOBS

Feb 8th 2001
From The Economist print edition

Japan's GDP growth for the third quarter was revised down from a quarterly rise of 0.2% to a drop of 0.6%. This change brought annual growth to 0.5%. Britain's industrial production fell by 0.6% in December, but its annual rate of increase remained at 0.5%. In January the unemployment rate edged up to 4.2% in America and 9.3% in Germany.

% change at annual rate	GDP		The Economist poll GDP forecasts		Industrial production		Retail sales (volume)	Unemployment % rate	
	3 mths†	1 year	2000	2001	3 mths†	1 year	1 year	latest	year ago
Australia	+ 2.6	+ 4.2 Q3	+ 4.3	+ 3.2	– 1.5	+ 4.2 Q3*	– 0.8 Q3	6.7 Jan	6.9
Austria	+ 1.2	+ 1.9 Q3	+ 3.4	+ 2.4	na	+ 6.7 Oct*	– 1.1 Oct	3.3 Dec	3.6
Belgium	+ 2.0	+ 3.2 Q3	+ 3.9	+ 2.7	na	+ 7.3 Dec*	+ 6.1 Oct	10.7 Jan*	11.3
Britain	+ 1.0	+ 2.4 Q4	+ 3.1	+ 2.5	– 2.9	+ 0.5 Dec	+ 4.4 Dec	5.3 Nov‡	5.9
Canada	+ 4.8	+ 5.0 Q3	+ 4.9	+ 2.8	+ 1.2	+ 4.5 Nov	+ 5.4 Oct	6.8 Dec	6.8
Denmark	+ 2.0	+ 2.7 Q3	+ 2.6	+ 2.1	na	+ 8.6 Dec	+ 0.2 Oct	5.4 Dec	5.4
France	+ 2.3	+ 3.0 Q3	+ 3.1	+ 2.6	+ 3.6	+ 2.3 Nov	– 1.5 Nov	9.2 Dec	10.6
Germany	+ 2.3	+ 2.8 Q3	+ 3.1	+ 2.4	+ 3.9	+ 4.9 Nov	+ 0.5 Nov	9.3 Jan	10.1
Italy	+ 2.4	+ 2.5 Q3	+ 2.6	+ 2.2	+ 1.9	+ 2.4 Nov	– 1.2 Nov	10.0 Oct	11.1
Japan	– 2.4	+ 0.5 Q3	+ 1.7	+ 1.4	+ 1.0	+ 3.5 Dec	– 0.3 Nov	4.8 Dec	4.7
Netherlands	+ 2.8	+ 3.3 Q3	+ 3.9	+ 3.0	+ 8.5	+ 9.4 Dec	+ 0.4 Oct	2.6 Dec§	2.7
Spain	+ 2.2	+ 3.9 Q3	+ 4.1	+ 3.1	– 0.5	+ 4.0 Nov	na	13.7 Dec	15.1
Sweden	+ 3.9	+ 4.0 Q3	+ 4.0	+ 3.2	na	+ 9.9 Nov	+ 4.0 Nov	3.7 Dec*	5.3
Switzerland	+ 2.0	+ 3.6 Q3	+ 3.4	+ 2.2	na	+ 6.9 Q3*	– 2.0 Dec	2.0 Jan*	2.6
United States	+ 1.4	+ 3.5 Q4	+ 5.0	+ 1.8	– 1.1	+ 3.1 Dec	+ 4.2 Nov	4.2 Jan	4.0
Euro area	+ 2.4	+ 3.3 Q3	+ 3.4	+ 2.6	+ 5.4	+ 4.4 Nov	+ 1.2 Nov	8.7 Dec	9.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Finland	+ 7.0	+ 5.6 Q3	na	na	+21.5	+17.3 Nov	+ 2.2 Oct	8.3 Dec*	9.1
Greece	na	+ 3.7 1999	na	na	na	– 7.2 Aug	+ 9.7 Aug	na	na
Iceland	na	+ 4.4 1999	na	na	na	+ 4.2 1999	na	1.3 Dec	1.7
Ireland	+21.5	+12.2 Q2	na	na	+31.0	+ 5.2 Jul	+ 9.7 Nov	3.6 Jan	4.6
Luxembourg	na	+ 7.5 1999	na	na	na	– 1.9 Oct*	+ 7.9 Aug	2.6 Nov	2.8
New Zealand	+ 2.7	+ 2.4 Q3	na	na	na	+11.5 Q3*	+ 1.7 Q3	5.6 Q4	6.3
Norway	+ 1.3	+ 1.0 Q3	na	na	+ 5.5	– 2.7 Dec	– 0.5 Nov	3.1 Q4	3.2
Portugal	+ 0.8	+ 2.6 Q2	na	na	na	+ 0.8 Nov*	+ 3.8 Oct	3.4 Q3	4.2

*Not seasonally adjusted. †Average of latest 3 months compared with average of previous 3 months, at annual rate. ‡Sep-Nov; claimant count rate 3.6% in December. §Oct-Dec.

Text refers only to the first 16 countries listed

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COMMODITY PRICE INDEX

Feb 8th 2001
From The Economist print edition

Trading on international cocoa exchanges reached record volumes in January as fears of a reduced crop in Côte d'Ivoire, which accounts for roughly 40% of the world's production, started waves of speculative buying. Average prices, which languished at 28-year lows last December, have since gained more than 40% to the highest in 19 months. Continuing political unrest in Côte d'Ivoire has forced migrant workers to flee the cocoa-growing region, leaving many pods unpicked. The crop may fall below 1m tonnes; the previous forecast had been for a crop of 1.3m tonnes. Moreover, excessive rain in Indonesia is likely to reduce its crop. Harvesting begins in April. Traders ED&F Man expect the deficit in supplies this season to exceed 150,000 tonnes.

1995=100	Jan 30th	Feb 6th*	% change on one month	% change on one year
Dollar index				
All items	72.7	71.8	– 1.6	– 4.5
Food	70.5	70.5	– 3.6	– 1.7
Industrials				
All	75.8	73.7	+ 1.0	– 7.8
Nfa†	67.7	66.6	+ 0.8	– 10.6
Metals	82.6	79.7	+ 1.2	– 5.7
Sterling index				
All items	78.6	77.6	+ 0.5	+ 5.4
Food	76.1	76.1	– 1.5	+ 8.5
Industrials	81.8	79.6	+ 3.2	+ 1.8
Euro index				
All items	103.5	101.4	– 0.7	+ 1.2
Food	100.3	99.5	– 2.7	+ 4.1
Industrials	107.8	104.0	+ 2.0	– 2.4
Yen index				
All items	90.3	87.9	– 2.9	+ 0.4
Food	87.5	86.2	– 4.8	+ 3.3
Industrials	94.1	90.1	– 0.2	– 3.1
Gold				
$ per oz	266.20	263.25	– 1.6	– 11.1
Crude oil North Sea Brent				
$ per barrel	26.62	28.58	+ 17.1	+ 7.5
West Texas Intermediate				
$ per barrel	29.10	30.26	+ 9.2	+ 7.7

* Provisional. † Non-food agriculturals.

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ECONOMIC FORECASTS

Feb 8th 2001
From The Economist print edition

Every month *The Economist* surveys a group of economic forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and the euro area. The table also shows the highest and lowest forecasts for growth. The previous month's forecasts, where different, are shown in brackets. This month the average of our forecasters' estimates for American growth in 2001 has slipped again; the figure fell from 3% in December to 2.3% in January and is now at 1.8%. The outlook for Japan has also deteriorated anew, with only 1.4% growth expected in 2001. Forecasts for most European countries have been shaded down, but a prediction of 2.6% growth suggests the euro area will considerably outpace America.

The Economist poll of forecasters, February averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2000	2001	2000	2001	2000	2001	2000	2001
Australia	4.2/4.6	2.5/3.6	4.3 (4.4)	3.2 (3.3)	4.6	4.1 (4.0)	4.2 (4.3)	3.4 (3.5)
Austria	3.0/3.6	1.8/2.9	3.4	2.4 (2.5)	2.1	1.7 (1.6)	2.6	2.4 (2.3)
Belgium	3.7/4.3	2.0/3.1	3.9	2.7 (2.8)	2.6	2.1	4.0 (4.1)	4.0
Britain	3.0/3.2	2.1/2.8	3.1 (3.0)	2.5 (2.6)	2.4	2.2 (2.3)	–1.5	–1.8 (–1.9)
Canada	4.7/5.0	1.7/3.7	4.9	2.8 (3.0)	2.7	2.4	1.3 (1.2)	0.6
Denmark	2.3/3.1	1.5/2.7	2.6	2.1	2.9	2.3	1.4 (1.3)	1.4 (1.3)
France	2.5/3.3	2.3/2.9	3.1 (3.2)	2.6 (2.7)	1.7 (1.8)	1.4 (1.6)	2.1 (2.3)	1.9
Germany	3.0/3.2	2.0/2.8	3.1	2.4 (2.5)	2.0 (1.9)	1.5 (1.6)	–1.3	–1.0 (–0.9)
Italy	2.5/2.7	1.6/2.5	2.6	2.2	2.5	2.1	–0.3	–0.2 (–0.3)
Japan	1.3/2.3	0.3/2.7	1.7 (1.8)	1.4 (1.6)	–0.7	–0.4	2.5	2.2
Netherlands	3.7/4.4	2.2/3.7	3.9	3.0 (3.1)	2.5 (2.4)	3.0 (3.1)	4.3 (4.9)	4.0 (4.4)
Spain	3.9/4.3	2.8/3.4	4.1 (4.0)	3.1 (3.2)	3.4	2.9	–3.4 (–3.5)	–3.0 (–3.1)
Sweden	3.7/4.4	2.6/3.8	4.0	3.2 (3.4)	1.3	1.7	2.1	2.1
Switzerland	3.0/3.6	1.8/2.8	3.4	2.2 (2.3)	1.6 (1.7)	1.4 (1.5)	12.3 (11.9)	11.7 (11.2)
United States	5.0/5.2	0.0/2.7	5.0 (5.1)	1.8 (2.3)	3.4 (3.3)	2.5 (2.6)	–4.3 (–4.4)	–4.2
Euro area	3.3/3.4	2.3/2.9	3.4	2.6 (2.7)	2.3	1.9	0.3	0.2

Sources: ABN Amro, Deutsche Bank, EIU, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan/Morgan Stanley Dean Witter, Nordbanken, Oxford Economics, Royal Bank of Canada, Salomon Smith Barney, Scotiabank, Shinsei Bank, Warburg Dillon Read.

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PRICES AND WAGES

Feb 8th 2001
From The Economist print edition

In January Italy's annual consumer-price inflation rose to 3.0%, the highest rate since September 1996. The Swiss inflation rate slowed to 1.3% in the year to January. Producer prices increased by 5.4% in the year to December in the euro area. American workers received a 3.9% pay rise in the year to January, a real change of 0.5%.

% change at annual rate	Consumer prices*		The Economist poll consumer prices forecast		Producer prices*		Wages/earnings	
	3 mths†	1 year	2000	2001	3 mths†	1 year	3 mths†	1 year
Australia	+ 1.2	+ 5.8 Q4	+ 4.6	+ 4.1	+10.2	+ 8.4 Q4	+ 8.1	+ 6.8 Q3
Austria	+ 2.8	+ 2.6 Dec	+ 2.1	+ 1.7	+ 2.1	+ 3.2 Jan	+ 1.9	+ 2.2 Dec
Belgium	+ 0.7	+ 2.2 Jan	+ 2.6	+ 2.1	+16.2	+10.0 Nov	+ 3.7	+ 1.6 Q4
Britain	+ 2.5	+ 2.9 Dec	+ 2.4	+ 2.2	+ 1.6	+ 2.4 Dec	+ 5.7	+ 4.4 Nov
Canada	+ 2.5	+ 3.2 Dec	+ 2.7	+ 2.4	+ 4.9	+ 3.5 Dec	+ 0.7	+ 3.4 Nov
Denmark	+ 2.7	+ 2.4 Dec	+ 2.9	+ 2.3	+ 3.0	+ 3.9 Dec	+ 7.0	+ 3.8 Q3
France	+ 1.7	+ 1.6 Dec	+ 1.7	+ 1.4	+ 5.2	+ 4.7 Dec	+ 4.6	+ 5.3 Q3
Germany	+ 1.7	+ 2.4 Jan	+ 2.0	+ 1.5	+ 5.3	+ 5.1 Dec	na	+ 1.8 Nov*
Italy	+ 3.1	+ 3.0 Jan	+ 2.5	+ 2.1	+ 6.1	+ 6.2 Dec	+ 0.9	+ 1.7 Dec*
Japan	+ 0.7	− 0.2 Dec	− 0.7	− 0.4	+ 1.4	+ 1.2 Jan	na	+ 1.8 Dec
Netherlands	+ 3.3	+ 2.9 Dec	+ 2.5	+ 3.0	+ 7.4	+ 7.6 Dec	+ 1.4	+ 3.0 Dec
Spain	+ 3.4	+ 4.0 Dec	+ 3.4	+ 2.9	+ 4.8	+ 5.0 Dec	+ 3.2	+ 2.4 Q3
Sweden	na	+ 1.4 Dec	+ 1.3	+ 1.7	+ 6.7	+ 3.7 Dec	+ 0.1	+ 2.1 Nov*
Switzerland	+ 2.0	+ 1.3 Jan	+ 1.6	+ 1.4	+ 1.8	+ 2.2 Dec	na	+ 0.2 1999
United States	+ 2.7	+ 3.4 Dec	+ 3.4	+ 2.5	+ 3.5	+ 3.6 Dec	+ 4.8	+ 3.9 Jan
Euro area	+ 2.1	+ 2.6 Dec	+ 2.3	+ 1.9	+ 5.7	+ 5.4 Dec	+ 1.2	+ 1.8 Q3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 2.1	+ 3.5 Dec	na	na	+ 5.4	+ 6.0 Dec	+ 1.3	+ 4.4 Q3*
Greece	+12.6	+ 3.9 Dec	na	na	+13.8	+ 9.0 Nov	na	na
Iceland	+ 4.4	+ 3.5 Jan	na	na	+ 2.8	+ 4.4 Jan	+ 1.9	+ 7.6 Dec
Ireland	+ 5.7	+ 5.9 Dec	na	na	+ 4.2	+ 4.5 Dec	− 5.7	+ 6.1 Q1*
Luxembourg	+ 5.5	+ 3.5 Dec	na	na	+ 1.2	+ 5.2 Oct	+11.7	+ 4.9 Sep*
New Zealand	+ 4.7	+ 4.0 Q4	na	na	+16.1	+ 8.0 Q3	+ 1.1	+ 1.5 Q3
Norway	+ 3.7	+ 3.0 Dec	na	na	+ 2.8	+ 3.8 Dec	+ 2.9	+ 3.8 Q3*
Portugal	+ 4.1	+ 3.9 Dec	na	na	+16.1	+13.4 Dec	na	+ 3.0 Nov*

*Not seasonally adjusted. †Average of latest 3 months compared with average of previous 3 months, at annual rate.

Text refers only to the first 16 countries listed

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MONEY AND INTEREST RATES

Feb 8th 2001
From The Economist print edition

Yields on 30-year American treasury bonds rose slightly to 5.5% after an association of bond traders advised that the demise of the "long bond" had been postponed; demand for the bonds, due to be phased out later this year, subsided.

	Money supply* % rise on year ago			Interest rates % p.a. (Feb 7th 2001)						
				over-	3-mth money market		banks	2-year	10-year gov't		corporate
	narrow	broad		night	latest	year ago	prime	gov't bonds	latest†	year ago	bonds
Australia	+9.3	+4.8	Dec	5.75	5.65	5.80	9.00	4.90	5.36	7.07	7.24
Britain	+4.8	+8.2	Dec	6.55	5.75	6.13	7.00	5.22	4.71	5.64	5.97
Canada	+14.2	+8.0	Dec	5.34	5.13	5.00	7.25	4.94	5.42	5.73	7.06
Denmark	na	+1.8	Dec	4.95	5.36	3.80	8.00	4.97	5.02	5.75	7.15
Japan	+4.6	+2.4	Jan	0.24	0.41	0.05	1.50	0.32	1.44	1.83	1.63§
Sweden	+1.9	+2.1	Dec	4.00	4.01	3.88	4.46	4.05	4.72	5.80	4.37
Switzerland	−2.6	−1.7	Dec	3.55	3.49	2.28	5.50	3.31	3.33	3.56	4.38
United States	3.0	+8.6	Dec	5.50	5.19	5.86	8.50	4.70	5.19	7.00	6.93
Euro area‡	+5.0	+4.9	Dec	4.76	4.65	3.49	5.55	4.41	4.69	5.39	5.53

† France 4.84, Germany 4.69, Italy 5.14. Benchmarks: Japan No.228 1.46, US 30-yr 5.52. ‡ Germany for prime and bonds. §New series.

*Narrow: V1 except Britain V0, broad M2 or M3 except Britain M4. Sources: Commerzbank, Den Danske, J.P. Morgan Chase, Royal Bank of Canada, Svenska Handelsbanken, Warburg Dillon Read, WEFA Group, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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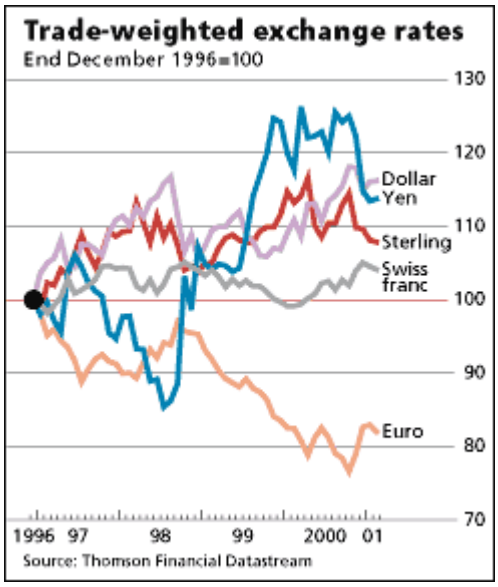
EXCHANGE RATES

Feb 8th 2001
From The Economist print edition

A country's trade-weighted exchange rate is an average of its bilateral exchange rates with its trading partners, weighted according to how much it trades with each of them. The measure captures the effect of currency fluctuations on the competitiveness of a country's exports; a rise represents a fall in competitiveness. The yen's trade-weighted value has plunged by 9% since the end of October, as the Japanese government abandoned its attempt to support the currency. Sterling's value has also slipped, by 6% in the same period. The euro, which lost 20% of its trade-weighted value between its launch in January 1999 and the end of October, has since rallied by 7%. Since the euro bottomed and the yen peaked in October, the dollar has slipped, but only by 2%—the movements in the currencies of America's trading partners have mostly cancelled out. Fears that America's weakening economy would lead the dollar to fall sharply have (so far) proved misplaced.



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TRADE, EXCHANGE RATES AND BUDGETS

Feb 8th 2001
From The Economist print edition

In the past week the trade-weighted value of the euro fell by 1%. Though the yen touched a one-month high against the dollar on February 5th, it lost 0.2% in trade-weighted terms over the week. The dollar was little changed but is now up 6.3% compared with its trade-weighted value a year ago. This week our table includes new forecasts for current-account balances.

	Trade balance*, $bn		Current account			Exchange rate		Currency units					Budget balance
	latest month	latest 12 months	$bn latest 12 mths	The Economist poll % of GDP, forecast 2000	2001	trade-weighted† Feb 7th	year ago	per $ Feb 7th	per $ year ago	per £	per euro	per ¥100	% of GDP 2000‡
Australia	-0.29 Dec	-4.6	-17.8 Q3	-4.2	-3.4	73.8	81.5	1.83	1.57	2.68	1.71	1.58	0.9
Austria	0.41 Oct§	4.0	4.4 Nov	2.5	2.4	100.5	100.8	14.8	13.9	21.6	13.8	12.72	1.5
Belgium	+1.69 Oct§	-13.5	+10.3 Sep	4.0	4.0	99.5	99.5	43.3	40.8	63.2	40.3	37.3	-0.1
Britain	3.06 Nov	42.4	16.3 Q3	1.5	1.8	103.7	109.6	0.68	0.62		0.64	0.59	2.7
Canada	+2.91 Nov	-33.6	+7.7 Q3	1.3	0.6	78.8	81.7	1.51	1.44	2.21	1.41	1.31	3.5
Denmark	+0.37 Nov	+4.3	+2.6 Nov	1.4	1.4	102.1	101.7	8.00	7.52	11.7	7.46	6.90	2.7
France	+0.01 Nov	-2.9	+26.9 Q3	2.1	1.9	102.2	102.5	7.03	6.63	10.3	6.56	6.06	-1.4
Germany	+2.22 Nov	+52.7	25.2 Nov	1.3	1.0	99.2	99.5	2.10	1.99	3.07	1.96	1.81	1.4
Italy	-0.18 Nov	-1.3	-5.8 Q3	-0.3	-0.2	72.9	73.2	2,076	1,956	3,006	1,936	1,790	-0.1
Japan	+8.18 Nov	-120.5	+120.0 Nov	2.5	2.7	147.8	147.0	116	105	170	108	–	-6.0
Netherlands	+0.90 Nov§	-12.4	+10.9 Q3	4.3	4.0	98.4	98.5	2.36	2.20	3.45	2.20	2.04	1.6
Spain	-3.10 Oct	-39.6	-15.2 Oct	-3.4	-3.0	74.5	74.6	178	158	261	166	154	-0.3
Sweden	+0.89 Dec	-14.1	+5.9 Nov	2.1	2.1	79.2	80.3	9.55	8.58	14.0	8.90	8.20	3.4
Switzerland	-0.17 Dec§	-1.1	+32.5 Q3	12.3	11.7	107.8	103.1	1.65	1.53	2.41	1.54	1.42	na
United States	-39.00 Nov	-441.7	-416.5 Q3	-4.3	-4.2	114.3	107.5	–	–	1.46	0.93	0.86	2.3
Euro area	+1.45 Nov§	-13.5	-26.2 Nov	-0.3	-0.7	80.1	91.5	1.07	1.01	1.57	–	0.92	0.3
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+0.58 Nov§	-13.3	+8.5 Nov	na	na	78.3	77.8	6.44	6.01	9.41	6.01	5.55	4.0
Greece	-1.80 Oct	-7.2	-7.6 Sep	na	na	57.6	59.1	369	336	539	344	318	-1.0
Iceland	-0.03 Nov§	-0.5	-0.7 Q3	na	na	na	na	86.3	73.3	126	80.5	74.4	2.8
Ireland	+2.85 Oct	-26.0	+0.2 Q3	na	na	88.5	88.1	0.85	0.80	1.24	0.79	0.73	5.6
Luxembourg	-0.19 Oct	-2.6	+1.6 Q3	na	na	99.5	99.5	43.7	40.9	63.5	40.8	37.7	na
New Zealand	-0.02 Dec§	-0.6	-3.3 Q3	na	na	81.5	84.6	2.28	2.00	3.33	2.13	1.97	0.5
Norway	+2.17 Nov	-25.5	+21.4 Nov	na	na	93.5	94.2	8.91	8.16	13.0	8.31	7.68	14.0
Portugal	-1.00 Sep§	-15.0	-11.0 Nov	na	na	89.7	89.6	217	200	317	202	187	-1.5

*Merchandise: Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.
§Not seasonally adjusted

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STOCKMARKETS

Feb 8th 2001
From The Economist print edition

The Dow briefly climbed above 11,000 on February 6th, for the first time since last September. But poor profit figures from Cisco hit the Nasdaq Composite, which lost 5.9% over the week. The Nikkei 225 fell again.

Market indices		2000-01		% change on one week	one year	record high	Dec 31st 1999 in local currency	in $ terms
	Feb 7th	high	low					
Australia (All Ordinaries)	3,262.8	3,330.4	2,920.0	– 0.9	+ 4.1	– 2.0	+ 3.5	– 13.6
Austria (ATX)	1,156.9	1,236.1	1,029.4	+ 4.8	+ 4.8	– 33.4	– 3.4	– 10.2
Belgium (Bel 20)	3,015.8	3,340.4	2,532.2	+ 1.6	+ 7.1	– 18.1	– 9.7	– 16.0
Britain (FTSE 100)	6,225.6	6,930.2	5,994.6	– 1.1	– 1.4	– 10.2	– 10.2	– 18.5
Canada (Toronto Composite)	9,137.6	11,388.8	8,114.2	2.0	1.3	19.8	+ 8.6	+ 4.1
Denmark (Copenhagen SE)	985.4	1,039.0	755.1	1.3	+ 21.1	5.2	+ 27.2	+ 18.0
France (SBF 250)	3,693.9	4,390.7	3,512.8	– 3.3	– 7.7	– 15.9	– 3.1	– 9.8
Germany (Xetra DAX)	6,579.0	8,065.0	6,200.7	– 3.2	– 13.8	– 18.4	– 5.4	– 12.0
Italy (BCI)	1,882.6	2,182.3	1,666.4	– 3.4	– 3.6	– 13.7	+ 3.6	– 3.6
Japan (Nikkei 225)	13,366.0	20,833.2	13,201.1	– 3.4	– 33.2	– 65.7	– 29.4	– 37.4
(Topix)	1,267.5	2,507.6	1,230.1	– 2.5	– 27.5	– 56.1	– 26.4	– 34.8
Netherlands (EOE)	624.9	701.6	612.4	– 2.4	– 6.3	– 10.9	– 6.9	– 13.4
Spain (Madrid SE)	943.0	1,146.2	857.9	2.0	11.4	17.7	6.5	13.0
Sweden (Affarsvarlden Gen)	281.1§	399.8§	261.7§	3.9	21.7	29.7	11.0	20.3
Switzerland (Swiss Market)	8,023.2	8,377.0	6,781.4	– 0.4	+ 14.1	– 4.6	+ 6.0	+ 2.9
United States (DJIA)	10,946.7	11,723.0	9,796.0	+ 0.5	+ 2.3	– 6.6	– 4.8	– 4.8
(S&P 500)	1,340.8	1,527.5	1,264.7	– 1.8	– 5.0	– 12.2	– 8.7	– 8.7
(Nasdaq Comp)	2,607.8	5,048.6	2,291.9	– 5.9	– 40.2	– 48.3	– 35.9	– 35.9
Europe (FTSE Eurotop 300)*	1,510.7	1,705.0	1,472.5	– 2.2	– 3.6	– 11.4	– 4.6	– 11.3
Euro area (FTSE Ebloc 100)*	1,363.4	1,550.5	1,277.7	2.9	5.5	12.1	1.5	8.4
World (MSCI)†	1,219.2	1,448.8	1,178.2	2.0	11.7	15.8	na	14.2
World bond market (Salomon)‡	444.8	447.8	414.8	+ 0.3	+ 4.0	– 3.3	na	+ 1.8

*In euro terms †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms ‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms §Rebased

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SHIPPING

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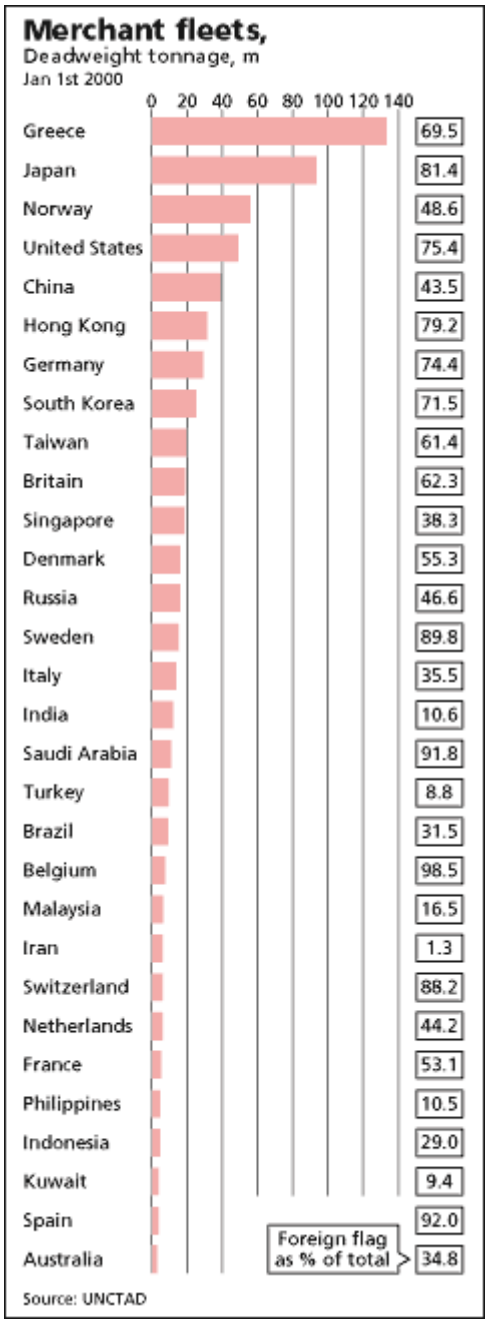
From The Economist print edition

Between them, Greek and Japanese shipping lines own more than 30% of the world's merchant tonnage, according to the United Nations Conference on Trade and Development. The world fleet grew slightly in 1999, as did emerging economies' share of it. Thanks to an increase in the deadweight tonnage of Asian countries—from 108.5m to 112.2m between 1998 and 1999—the developing world's share rose to 19.2%. Though total tonnage has increased, the average age of merchant ships has declined. This is especially true of developing countries' container vessels, whose average age fell from 11.4 years to 9.1 years. Almost 40% of these ships are under four years old. Following a growing trend, about two-thirds of ships from rich countries sail under foreign flags, compared with just over half of their poorer counterparts. Not surprisingly, hardly any Iranian vessels are foreign-flagged. Perhaps more surprising is the existence of a Swiss merchant fleet.



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FINANCIAL MARKETS

Feb 8th 2001
From The Economist print edition

The slide in high-tech and telecom shares dogged most markets this week. Political worries continued to plague Istanbul, which lost 9.0%. Tel Aviv fell 1.2% after Ariel Sharon was elected prime minister but ended the week only 0.3% lower. Jakarta did well: the return of foreign investors pushed the index close to a five-month high on February 5th.

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Feb 7th		Dec 31st 1999	
	Feb 7th	year ago	Feb 7th	% p.a.		one week	In local currency	In $ terms
China	8.28	8.28	12.1	5.40	2,094.4	− 4.2	+ 44.3	+ 44.3
Hong Kong	7.80	7.78	11.4	5.19	16,049.5	− 0.3	− 5.4	− 5.7
India	46.4	43.6	67.9	8.71	4,312.9	0.3	13.8	19.2
Indonesia	9,646	7,215	14,101	15 00	444.3	+ 4.4	− 34.4	− 52 0
Malaysia	3 80	3.80	5.56	3 30	729.1	+ 0.2	− 10.2	− 10 2
Philippines	48.6	40.5	71.0	13.25	1,659.3	− 1.6	− 22.6	− 35.7
Singapore	1.75	1.69	2.56	2.00	1,942.7	− 2.4	− 21.7	− 25.3
South Korea	1,268	1,124	1,853	5.80	576.2	− 6.8	− 44.0	− 49.9
Taiwan	32.2	30.6	47.1	5.15	5,693.6	4.1	32.6	34.4
Thailand	42.6	37 5	62 3	3 25	327.5	− 1.6	− 32.0	− 40 1
Argentina	1.00	1.00	1.46	7.83	503.9	− 5.4	− 8.2	− 8.2
Brazil	2.01	1.77	2.93	15.10	16,812.4	− 4.9	− 1.6	− 12.0
Chile	562	515	822	4.28*	5,013.7	− 1.8	− 3.0	− 8.6
Colombia	2,240	1,947	3,274	13.54	802.2	+ 2.5	19.6	32.7
Mexico	9.70	9.40	14.2	18.01	6,350.4	2.3	10.9	13.0
Peru	3 53	3.45	5 2	11 00	1,316.4	+ 2.8	− 28.3	− 28 7
Venezuela	702	658	1,026	14.04	7,921.1	+ 0.2	+ 46.2	+ 35.2
Egypt	3.89	3.45	5.68	9.09	7,535.9	− 1.5	− 42.2	− 49.1
Israel	4.14	4.07	6.06	5.72	444.2	− 0.3	− 8.8	− 8.5
South Africa	7.87	6.31	11.5	10.45	9,155.9	+ 0.9	+ 7.2	16.1
Turkey	677,520	559,975	990,466	41 00	9,724.1	− 9.0	− 36.1	− 48 8
Czech Republic	37.1	36.0	54.3	5.31	486.1	− 3.1	− 0.7	− 4.0
Hungary	285	258	416	11.00	7,743.6	− 4.9	− 12.2	− 21.6
Poland	4.06	4.14	5.93	18.65	16,829.8	− 4.4	− 6.9	− 5.1
Russia	28.5	28.7	41.7	25.00	166.6†	4.0	3.0	6.3

* nflation-adjusted † ndollar terms.

Sources: National statistics offices, central banks and stock exchanges; Primark Datastream; EIU; Reuters; Warburg Dillon Read; J.P. Morgan; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Bank Ekspres; Deutsche Bank; *Russian Economic Trends*.

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ECONOMY

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From The Economist print edition

Singapore's industrial output rose by 5.7% in December; the change lifted the annual rate of growth to 20.0%. Consumer-price inflation quickened to 2.4% in Taiwan and slowed to 12.6% in Venezuela in the 12 months to January. In the past year Poland's trade deficit and Indonesia's trade surplus both narrowed, to $11.0 billion and $28.3 billion respectively.

	% change on year earlier			Latest 12 months, $bn		Foreign reserves*, $bn	
	GDP	Industrial production	Consumer prices	Trade balance	Current account	Latest	Year ago
China	+ 7.4 Q4	+10.4 Dec	+ 1.5 Dec	+24.1 Dec	+15.7 1999	163.9 Nov	156.8
Hong Kong	+10.4 Q3	− 0.1 Q3	− 1.8 Dec	−10.9 Dec	+ 9.2 Q3	107.5 Dec	96.3
India	+ 7.2 Q4†	+ 2.7 Nov	+ 3.5 Dec	− 8.3 Dec	− 5.6 Q3	37.3 Dec	32.7
Indonesia	+ 5.1 Q3	+38.4 Q4†	+ 8.3 Jan	+28.3 Dec	+ 6.2 Q1	29.0 Nov	26.3
Malaysia	+ 7.7 Q3	+11.1 Nov	+ 1.4 Dec	+16.8 Nov	+11.3 Q2	29.6 Nov	29.8
Philippines	+ 4.8 Q3	+36.6 Nov	+ 6.9 Jan	+ 5.7 Nov	+ 9.1 Aug	12.5 Oct	12.8
Singapore	+10.5 Q4	+20.0 Dec	+ 2.1 Dec	+ 4.0 Nov	+21.6 Q3	77.5 Nov	74.3
South Korea	+ 9.2 Q3	+ 4.7 Dec	+ 4.2 Jan	+12.9 Jan	+11.7 Nov	96.2 Dec	74.0
Taiwan	+ 6.6 Q3	− 2.1 Dec	+ 2.4 Jan	+ 8.1 Jan	+ 7.5 Q3	108.2 Nov	103.5
Thailand	+ 2.6 Q3	+ 1.5 Dec	+ 1.3 Jan	+ 5.6 Dec	+ 9.2 Dec	32.0 Dec	34.1
Argentina	nil Q3	− 3.4 Dec	− 0.7 Dec	+ 0.6 Nov	−10.5 Q3	25.2 Dec	26.3
Brazil	+ 4.5 Q3	+ 4.9 Nov	+ 5.3 Dec	− 1.1 Jan	−24.6 Dec	32.5 Nov	42.2
Chile	+ 5.8 Q3	− 3.8 Dec	+ 4.7 Jan	+ 1.5 Dec	− 0.7 Q3	14.2 Nov	14.1
Colombia	+ 3.1 Q3	+11.2 Nov	+ 8.8 Dec	+ 2.3 Nov	+ 0.1 Q2	8.1 Dec	7.6
Mexico	+ 7.1 Q3	+ 4.6 Nov	+ 9.0 Dec	− 8.0 Dec	−16.4 Q3	34.7 Nov	31.7
Peru	+ 0.1 Nov	+ 0.9 Nov**	+ 3.9 Jan	− 0.4 Nov	− 1.6 Q3	8.6 Oct	9.0
Venezuela	+ 3.3 Q3	na	+ 12.6 Jan	+14.4 Jul	+11.8 Q3	13.1 Dec	12.3
Egypt	+ 6.5 2000‡	+ 9.4 2000‡	+ 2.4 Nov	−10.8 Q3	− 0.9 Q3	12.9 Oct	15.4
Israel	+ 7.3 Q3	+ 6.0 Nov	nil Dec	− 6.9 Dec	− 0.7 Q3	23.2 Jan	22.1
South Africa	+ 4.5 Q3	+ 4.1 Dec	+ 7.0 Dec	+ 3.2 Dec	− 0.7 Q3	6.1 Nov	6.3
Turkey	+ 7.4 Q3	+10.5 Nov	+ 35.9 Jan	−27.4 Nov	− 9.2 Oct	18.8 Nov	22.7
Czech Republic	+ 2.2 Q3	+ 4.3 Nov	+ 4.0 Dec	− 3.3 Dec	− 1.9 Q3	13.1 Dec	12.9
Hungary	+ 4.6 Q3	+10.1 Dec	+ 10.1 Dec	− 2.2 Nov	− 0.6 Nov	10.8 Nov	10.9
Poland	+ 2.2 Q4	− 2.2 Dec	+ 8.5 Dec	−11.0 Dec	− 9.9 Dec	24.6 Nov	24.5
Russia	+ 7.9 Q4	+ 2.5 Dec	+ 20.2 Dec	+59.8 Nov	+43.8 Q3	24.0 Nov	7.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*						
Pakistan	+ 3.9 1999‡	+ 4.6 Jul	+ 4.9 Nov	− 2.0 Nov	− 2.5 1999	1.2 Dec	1.5
Saudi Arabia	+ 0.4 1999	na	− 1.0 Oct	+24.9 1999	− 1.7 1999	16.7 Oct	14.1

*Excluding gold, except Singapore; IMF definition. †1999. ‡Year ending June. **New series

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